




### Question #1 of 94

Question ID: 1457534

The cash conversion cycle is the:

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

#### Explanation

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

(Module 21.2, LOS 21.b)

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### Question #2 of 94

Question ID: 1457535

An analyst has gathered the following information about a company:

### Balance Sheet

#### Assets

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

#### Liabilities and Equity

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

### Income Statement

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

What is the receivables collection period?

A) 243.



**B) 183.**



**C) 365.**



### Explanation

Receivables turnover =  $1,500(\text{sales}) / 750(\text{receivables}) = 2.0$

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

(Module 21.2, LOS 21.b)

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### Question #3 of 94

Question ID: 1462836

The following data pertains to a company's common-size financial statements.

- Current assets 40%
- Total debt 40%
- Net income 16%
- Total assets \$2,000
- Sales \$1,500
- Total asset turnover ratio 0.75
- The firm has no preferred stock in its capital structure.

The company's after-tax return on common equity is *closest* to:

**A) 20%.**



**B) 15%.**



**C) 25%.**



### Explanation




$$\text{ROE} = \frac{\text{net income}}{\text{equity}} = \frac{0.16(1,500)}{(1-0.40)(2,000)} = 0.20, \text{ or } 20\%$$

If the debt ratio (TD/TA) is equal to 40% and the firm has no preferred stock, the percentage of equity is  $1 - 0.40$ , or 60%. (Module 21.3, LOS 21.b)

#### Question #4 of 94

Question ID: 1482631

Which of the following *most* accurately represents the cash conversion cycle?

- A) average days of receivables + average days of inventory – average days of payables. 
- B) average days of receivables + average days of inventory + average days of payables. 
- C) average days of payables + average days of inventory – average days of receivables. 

#### Explanation

The cash conversion cycle, also called the net operating cycle is:

$$\text{cash conversion cycle} = \left( \begin{array}{c} \text{average days} \\ \text{of receivables} \end{array} \right) + \left( \begin{array}{c} \text{average days} \\ \text{of inventory} \end{array} \right) - \left( \begin{array}{c} \text{average days} \\ \text{of payables} \end{array} \right)$$

The cash conversion cycle measures the length of time required to convert a firm's cash investment in inventory back into cash resulting from the sale of the inventory. A short cash conversion cycle is good because it indicates a relatively low investment in working capital.

(Module 21.2, LOS 21.b)

#### Question #5 of 94

Question ID: 1457592

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

- A) 2.50. 
- B) 3.15. 

C) 1.85.



### Explanation

ROE in 20X4 was  $0.18 \times 1.75 \times 1.5 = 0.4725$ .

If ROE for 20X5 is unchanged from 20X4, then:

$$0.10 \times \text{asset turnover} \times 1.5 = 0.4725$$

$$\text{Asset turnover} = 3.15.$$

(Module 21.4, LOS 21.d)

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### Question #6 of 94

Question ID: 1457544

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

A) 2.89.



B) 3.71.



C) 3.25.



### Explanation

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

(Module 21.2, LOS 21.b)

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### Question #7 of 94

Question ID: 1457543

An analyst has collected the following data about a firm:

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

The firm's cash conversion cycle is *closest* to:

A) 134 days.



**B) 52 days.**



**C) 82 days.**



**Explanation**

Days of sales outstanding =  $365 / 10 = 36.5$  days

Days of inventory on hand =  $365 / 8 = 45.6$  days

Days of payables =  $365 / 12 = 30.4$  days

Cash conversion cycle =  $36.5 + 45.6 - 30.4 = 51.7$  days

(Module 21.2, LOS 21.b)

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**Question #8 of 94**

Question ID: 1457542

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

**A) Gross profit margin.**



**B) Payables turnover.**



**C) Fixed asset turnover.**



**Explanation**

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

(Module 21.2, LOS 21.b)

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**Question #9 of 94**

Question ID: 1482632

A high cash conversion cycle suggests that a company's investment in working capital is:

**A) appropriate.**



**B) too high.**



**C) too low.**



**Explanation**

The cash conversion cycle is equal to average days of receivables plus average days of inventory minus average days of payables. High cash conversion cycles relative to those of comparable firms are considered undesirable. A cash conversion cycle that is too high implies that the company has excessive investment in working capital.

(Module 21.2, LOS 21.b)

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### Question #10 of 94

Question ID: 1462834

Books Forever, Inc., uses short-term bank debt to buy inventory. Assuming an initial current ratio that is greater than 1, and an initial quick (or acid test) ratio that is less than 1, what is the effect of these transactions on the current ratio and the quick ratio?

- A) Only one ratio will decrease.
- B) Both ratios will decrease.
- C) Neither ratio will decrease.



#### Explanation

As an example, start with CA = 2, CL = 1, and Inv = 1.2. We begin with a current ratio of 2 and a quick ratio of 0.8. If the firm increases short-term bank debt (a current liability) by 1 to buy inventory (a current asset) of 1, both the numerator and denominator increase by 1, resulting in  $\frac{3}{2} = 1.5$  (new current ratio) and  $\frac{3-2.2}{2} = 0.4$  (new quick ratio). (Module 21.2, LOS 21.b)

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### Question #11 of 94

Question ID: 1462835

Which of the following statements about financial ratios is *most accurate*?

- A) A company with a high debt-to-equity ratio will have a return on assets that is greater than its return on equity.
- B) Any firm with a high net profit margin will have a high gross profit margin and vice versa.
- C) A company that has an inventory turnover of 6 times, a receivables turnover of 9 times, and a payables turnover of 12 times will have a cash conversion cycle of approximately 71 days.



#### Explanation

The cash conversion cycle is  $(365 / 6) + (365 / 9) - (365 / 12) = 60.8 + 40.6 - 30.4 = 71$  days. ROA is less than ROE when net income is positive and debt is present. The fact that a company has a high gross profit margin does not necessarily mean it will have a high net profit margin. A company with a high gross margin may have a low (or negative) net margin if its operating expenses are high. (Module 21.2, LOS 21.b)

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### Question #12 of 94

Question ID: 1457553

Bentlom Company's common-size financial statements show the following information:

- Current liabilities 20%
- Equity 45%

Bentlom's long-term debt-to-equity ratio is *closest* to:

- A) 98%.
- B) 88%.
- C) 78%.



#### Explanation

If equity equals 45% of assets and current liabilities equal 20% of assets, long-term debt must be  $100 - 45 - 20 = 35\%$  of assets.

$$\text{long-term debt to equity ratio} = \frac{\text{long-term debt}}{\text{total equity}} = \frac{0.35}{0.45} = 77.8\%$$

(Module 21.2, LOS 21.b)

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### Question #13 of 94

Question ID: 1457560

Which of the following is *least likely* a routinely used operating profitability ratio?

- A) Gross profit/net sales.
- B) Net income/net sales.
- C) Sales/Total Assets.



#### Explanation

Sales/Total Assets, or Total Asset Turnover is a measure of operating efficiency, not operating profitability.

(Module 21.3, LOS 21.b)



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**Question #14 of 94**

Question ID: 1457515

Which of the following statements *best* describes vertical common-size analysis and horizontal common-size analysis?

Statement #1 – Each line item is expressed as a percentage of its base-year amount.

Statement #2 – Each line item of the income statement is expressed as a percentage of revenue and each line item of the balance sheet is expressed as a percentage of ending total assets.

Statement #3 – Each line item is expressed as a percentage of the prior year's amount.

Vertical analysis   Horizontal analysis

**A)** Statement #2   Statement #1



**B)** Statement #1   Statement #2



**C)** Statement #2   Statement #3

**Explanation**

Horizontal common-size analysis involves expressing each line item as a percentage of the base-year figure. Vertical common-size analysis involves expressing each line item of the income statement as a percentage of revenue and each line item of the balance sheet as a percentage of ending total assets.

(Module 21.1, LOS 21.a)

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**Question #15 of 94**

Question ID: 1457519

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

**A)** cross-sectional analysis.



**B)** common-size analysis.



**C)** longitudinal analysis.

**Explanation**

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

(Module 21.1, LOS 21.a)

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**Question #16 of 94**

Question ID: 1457531

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

**A)** Cash.



**B)** Receivables.



**C)** Inventory.

**Explanation**

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

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

(Module 21.2, LOS 21.b)

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**Question #17 of 94**

Question ID: 1457549

An analyst has gathered the following information about a firm:

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

What is their receivables balance?

**A)** 3 million.



**B)** 5 million.



**C)** 2 million.

**Explanation**

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

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

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

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

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

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

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

\$15,000,000 - \$12,000,000 = receivables

\$3,000,000 = receivables

(Module 21.2, LOS 21.b)

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### Question #18 of 94

Question ID: 1457538

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

**A)** marketable securities.



**B)** inventory.



**C)** non-current assets.



#### Explanation

Current ratio = current assets / current liabilities

Quick ratio = (current assets - inventories) / current liabilities

Marketable securities are included among current assets in both ratios. Neither ratio considers non-current assets.

(Module 21.2, LOS 21.b)

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### Question #19 of 94

Question ID: 1457533

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

**A)** 171.64 days.



**B)** 6.50 days.



C) 80.38 days.



### Explanation

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

(Module 21.2, LOS 21.b)

### Question #20 of 94

Question ID: 1457578

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

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

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

A) both gross profit margin and net profit margin increased in 20X1.



B) gross profit margin decreased but net profit margin increased in 20X1.



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



### Explanation

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




(Module 21.3, LOS 21.c)

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### Question #21 of 94

Question ID: 1457520

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

- A) variations in accounting treatments have little effect on financial ratios. 
- B) a range of target values for a ratio may be more appropriate than a single target value. 
- C) many financial ratios are useful in isolation. 

#### Explanation

A range of target values for a financial ratio may be more appropriate than a single numerical target. Financial ratios are not useful when viewed in isolation and are only valid when compared to historical figures or peers. Comparing ratios among firms can be complicated by variations in accounting treatments used at each firm.

(Module 21.1, LOS 21.a)

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### Question #22 of 94

Question ID: 1457566

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

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

#### Explanation

Operating profit = earnings before interest and taxes (EBIT)

Gross profit = net sales – COGS

Net income = earnings after taxes = EAT

(Module 21.3, LOS 21.b)

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**Question #23 of 94**

Question ID: 1457568

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

Earnings after taxes = 18%

Equity = 40%

Current assets = 60%

Current liabilities = 30%

Sales = \$300

Total assets = \$1,400

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

**A)** 5.0%.



**B)** 9.6%.



**C)** 18.0%.

**Explanation**

Net income after taxes =  $300 \times 0.18 = 54$

Equity =  $1400 \times 0.40 = 560$

ROE = Net Income / Equity =  $54 / 560 = 0.0964 = 9.6\%$

(Module 21.3, LOS 21.b)

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**Question #24 of 94**

Question ID: 1457599

A firm's financial statements reflect the following:

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

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

**A) 7.35%.**



**B) 10.63%.**



**C) 8.82%.**



#### Explanation

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

tax burden = net income/EBT

EBT = EBIT - I = 2,000,000 - 900,000 = 1,100,000

net income = (EBT)(1-t) = (1,100,000)(1 - 0.35) = 715,000

tax burden = 715,000/1,100,000 = 0.65

interest burden = EBT/EBIT = 1,100,000/2,000,000 = 0.55

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

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

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

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

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

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

(Module 21.5, LOS 21.e)

A company has a cash conversion cycle of 80 days. If the company's average receivables turnover increases from 11 to 12, the company's cash conversion cycle:

- A) decreases by approximately 1 day.
- B) increases by approximately 3 days.
- C) decreases by approximately 3 days.



#### Explanation

Cash conversion cycle (CCC) = days of sales outstanding + days of inventory on hand – number of days of payables. Days of sales outstanding =  $365 / \text{receivables turnover} = 365 / 11 = 33.18$ ;  $365 / 12 = 30.42$ . This means the CCC decreases by 2.76 days. (Module 21.2, LOS 21.b)

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### Question #26 of 94

Question ID: 1457597

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

- A) 4.55%.
- B) 4.95%.
- C) 5.81%.



#### Explanation

$\text{ROE} = \text{profit margin} \times \text{asset turnover} \times \text{A/E} = 0.08 \times 1.2 \times 1.1 = 0.1056$

$\text{RR} = (1 - 0.45) = 0.55$

$g = \text{ROE} \times \text{RR} = 0.1056 \times 0.55 = 0.0581$

(Module 21.5, LOS 21.e)

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### Question #27 of 94

Question ID: 1457577



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

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

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

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

A) 0.62.



B) 1.83.



C) 0.29.



### Explanation

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

If using the traditional DuPont,  $ROE = (NI / \text{Sales}) \times (\text{Sales} / \text{Assets}) \times (\text{Assets} / \text{Equity})$ :

$$ROE = (944 / 3,000) \times (3,000 / 2,920) \times (2,920 / 1,519) = 0.622$$

The 5-part Dupont formula gives the same result:

$$ROE = (\text{net income} / \text{EBT})(\text{EBT} / \text{EBIT})(\text{EBIT} / \text{revenue})(\text{revenue} / \text{total assets})(\text{total assets} / \text{total equity})$$

Where  $EBIT = \text{EBT} + \text{interest} = 1,349 + 151 = 1,500$

$$ROE_{2007} = (944 / 1,349)(1,349 / 1,500)(1,500 / 3,000)(3,000 / 2,920)(2,920 / 1,519) = 0.622$$

(Module 21.3, LOS 21.c)

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### Question #28 of 94

Question ID: 1457559

A company has a cash conversion cycle of 70 days. If the company's payables turnover decreases from 11 to 10 and days of sales outstanding increase by 5, the company's cash conversion cycle will:

A) decrease by approximately 8 days.



B) increase by approximately 2 days.



C) decrease by approximately 3 days.



### Explanation

$\text{cash conversion cycle (CCC)} = \text{days of sales outstanding} + \text{days of inventory on hand} - \text{number of days of payables}$

$$\begin{aligned} \text{number of days of payables} &= \frac{365}{\text{payables turnover}} = \frac{365}{11} = 33.18 \text{ days;} \\ &\quad \frac{365}{10} = 36.5 \text{ days} \end{aligned}$$

Since the payables payment period increases by 3.32 days and receivables days increases by 5, CCC increases by 1.68 days.

(Module 21.2, LOS 21.b)

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**Question #29 of 94**

Question ID: 1457598

A firm's financial statements reflect the following:

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

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

**A)** 10%.



**B)** 8%.



**C)** 9%.

**Explanation**

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

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

(Module 21.5, LOS 21.e)

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**Question #30 of 94**

Question ID: 1457541

An analyst has gathered the following information about a company:

### Balance Sheet

#### Assets

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

#### Liabilities and Equity

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

### Income Statement

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

What is the inventory turnover ratio?

**A) 0.77.**



B) 1.29.



C) 1.59.



### Explanation

Inventory turnover =  $1,100(\text{COGS}) / 850(\text{inventory}) = 1.29$

(Module 21.2, LOS 21.b)

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### Question #31 of 94

Question ID: 1457575

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

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

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

Transaction #1

Transaction #2

A) Higher

Higher



B) Higher

Lower



C) Lower

Higher



### Explanation

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

(Module 21.3, LOS 21.b)

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### Question #32 of 94

Question ID: 1457580

Selected financial information gathered from the Matador Corporation follows:

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

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

**A)** Gross profit margin has improved.



**B)** Leverage has declined.



**C)** Return on equity has improved.



#### Explanation

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

(Module 21.3, LOS 21.c)

### Question #33 of 94

Question ID: 1457586

The traditional DuPont equation decomposes return on equity as:

**A)** net income/assets  $\times$  sales/equity  $\times$  assets/sales.



**B)** EBIT/sales  $\times$  sales/assets  $\times$  assets/equity  $\times$  (1 – tax rate).



**C)** net income/sales  $\times$  sales/assets  $\times$  assets/equity.



#### Explanation

The traditional three-part DuPont decomposition of ROE is profit margin × asset turnover × financial leverage. Although ROE can also be decomposed as net income/assets × sales/equity × assets/sales, this is not the DuPont equation.

(Module 21.4, LOS 21.d)

### Question #34 of 94

Question ID: 1457564

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

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

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

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

Current ratio

Return on equity

A) 2.4

24.5%



B) 2.4

26.8%



C) 4.6

25.2%



### Explanation

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

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

(Module 21.3, LOS 21.b)

### Question #35 of 94

Question ID: 1457571

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

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

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

	<u>Debt to Equity</u>	<u>Working Capital</u>	
A) 0.78	\$250		
B) 0.78	\$500		
C) 1.22	\$500		

### Explanation



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

$$\text{Long-Term Debt} / \text{Equity} = 0.35 / 0.45 = 0.78$$

$$\text{Working capital} = \text{CA} - \text{CL} = 45\% - 20\% = 25\% \text{ of assets}$$

$$\text{WC} = 2,000(0.25) = \$500$$

(Module 21.3, LOS 21.b)

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### Question #36 of 94

Question ID: 1457595

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

	<u>Net profit margin</u>	<u>Dividend payout ratio</u>	
A) Yes	Yes		✗
B) No	No		✗
C) Yes	No		✓

#### Explanation

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

(Module 21.5, LOS 21.e)

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### Question #37 of 94

Question ID: 1457603

Companies are required to report segment data under:

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

#### Explanation

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

(Module 21.5, LOS 21.f)

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### Question #38 of 94

Question ID: 1457591

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

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

#### Explanation

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

(Module 21.4, LOS 21.d)

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### Question #39 of 94

Question ID: 1457596

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

Statement #2 – A firm with earnings per share of \$2 is more profitable than a firm with earnings per share of \$1.

With respect to these statements:

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

#### Explanation

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

(Module 21.5, LOS 21.e)

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### Question #40 of 94

Question ID: 1462833

A company has 1,000,000 warrants outstanding at the beginning of the year, each convertible into one share of stock with an exercise price of \$50. No new warrants were issued during the year. The average stock price during the period was \$60, and the year-end stock price was \$45. What adjustment for these warrants should be made, under the treasury stock method, to the number of shares used to calculate diluted earnings per share (EPS)?

A) 166,667.



B) 200,000.



C) 0.



#### Explanation

Diluted EPS uses average price. Since the average price is greater than the exercise price, the warrants are dilutive.

$$\frac{60-50}{60} \times 1,000,000 = 166,667$$

(Module 21.2, LOS 21.b)

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### Question #41 of 94

Question ID: 1457527

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

A) 79 days.



B) 30 days.



C) 37 days.



### Explanation

Cash conversion cycle = receivables days + inventory processing days – payables payment period.

Receivables days =  $365 / \text{receivables turnover} = 365 / 10 = 36.5$  days.

Inventory processing days =  $365 / \text{inventory turnover} = 365 / 5 = 73.0$  days.

Payables payment period =  $365 / \text{payables turnover} = 365 / 12 = 30.4$  days.

Cash collection cycle =  $36.5 + 73.0 - 30.4 = 79.1$  days.

(Module 21.2, LOS 21.b)

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### Question #42 of 94

Question ID: 1457517

Which of the following reasons is *least likely* a valid limitation of ratio analysis?

**A)** Determining the target or comparison value for a ratio is difficult.



**B)** Calculation of ratios involves a large degree of subjectivity.



**C)** It is difficult to find comparable industry ratios.



### Explanation

There is not a great deal of subjectivity involved in calculating ratios. The mechanical formulas for the calculations are fairly standard and objective for the activity, liquidity, solvency, and profitability ratios, for instance. On the other hand, determining the target or comparison value for a ratio is difficult as it requires some range of acceptable values and that introduces an element of subjectivity. Conclusions cannot be made from viewing one set of ratios as all ratios must be viewed relative to one another in order to make meaningful conclusions. It can be difficult to find comparable industry ratios, especially when analyzing companies that operate in multiple industries.

(Module 21.1, LOS 21.a)

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### Question #43 of 94

Question ID: 1457532

If a firm has net annual sales of \$250,000 and average receivables of \$150,000, its average collection period is *closest* to:

**A)** 46.5 days.



**B)** 219.0 days.



**C)** 1.7 days.



**Explanation**

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

Collection period =  $365 / 1.66667 = 219$  days

(Module 21.2, LOS 21.b)

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**Question #44 of 94**

Question ID: 1457583

An analyst has gathered the following information about a company:

### Balance Sheet

#### *Assets*

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

#### *Liabilities and Equity*

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

### Income Statement

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

What is the ROE?

**A) 10.7%.**



**B)** 9.9%.



**C)** 9.3%.



#### Explanation

$ROE = 150(NI) / [1000(\text{common}) + 620(RE)] = 150 / 1620 = 0.0926$  or 9.3%

(Module 21.4, LOS 21.d)

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#### Question #45 of 94

Question ID: 1457528

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

**A)** lengthens.



**B)** shortens.



**C)** may shorten or lengthen.



#### Explanation

CCC = collection period + Inv Period – Payment period.

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

(Module 21.2, LOS 21.b)

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#### Question #46 of 94

Question ID: 1457526

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

**A)** current liabilities.



**B)** total assets.



**C)** total liabilities.



#### Explanation

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

(Module 21.2, LOS 21.b)

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**Question #47 of 94**

Question ID: 1457565

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

Current ratio	2.00
Quick ratio	1.25
Current liabilities	\$100,000
Inventory turnover	12
Gross profit %	25

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

**A)** \$1,200,000.



**B)** \$900,000.



**C)** \$300,000.

**Explanation**

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

(Module 21.3, LOS 21.b)

**Question #48 of 94**

Question ID: 1457561

Are the following ratios *best* classified as profitability ratios?

Ratio #1 – Cash plus short-term marketable investments plus receivables divided by average daily cash expenditures.

Ratio #2 – Earnings before interest and taxes divided by average total assets.

**A)** Both of the ratios are profitability ratios.



**B)** Neither of the ratios is a profitability ratio.



**C)** Only one of the ratios is a profitability ratio.





**Explanation**

(Cash + short-term marketable investments + receivables) divided by average daily cash expenditures is known as the defensive interval ratio. The defensive interval ratio is a liquidity ratio that measures the firm's ability to pay cash expenditures in the absence of external cash flows, but does not directly measure profitability. EBIT / average total assets is one variation of the return on assets ratio. Return on assets is a profitability ratio that measures the efficiency of managing assets and generating profits.

(Module 21.3, LOS 21.b)

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

Balance Sheet		
<i>Assets</i>	<i>Year 2003</i>	<i>Year 2004</i>
Cash	500	450
Accounts Receivable	600	660
Inventory	<u>500</u>	<u>550</u>
<i>Total CA</i>	1600	1660
Plant, prop. equip	<u>1000</u>	<u>1250</u>
<i>Total Assets</i>	2600	2910
<i>Liabilities</i>		
Accounts Payable	500	550
Long term debt	<u>700</u>	<u>1102</u>
<i>Total liabilities</i>	1200	1652
<i>Equity</i>		
Common Stock	400	538
Retained Earnings	<u>1000</u>	<u>720</u>
<i>Total Liabilities &amp; Equity</i>	2600	2910

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

What is the quick ratio for 2004?

**A)** 2.018.



**B)** 3.018.



**C)** 0.331.



#### Explanation

Quick ratio = (cash + marketable securities + receivables) / CL = (450 + 0 + 660) / 550 = 2.018

(Module 21.2, LOS 21.b)

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### Question #50 of 94

Question ID: 1457590

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

**A)** Net profit margin, asset turnover, asset multiplier.



**B)** Gross profit margin, asset turnover, equity multiplier.



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



#### Explanation

The three ratios can be further decomposed as follows:

Net profit margin = net income/sales

Asset turnover = sales/assets

Equity multiplier = assets/equity

(Module 21.4, LOS 21.d)

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### Question #51 of 94

Question ID: 1457601

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

**A)** accounts for more than 10% of the firm's assets and has risk and return characteristics distinguishable from the company's other lines of business.



**B)** is located in a country other than the firm's home country.



**C)** is more than 20% of a firm's revenues.



### Explanation

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

(Module 21.5, LOS 21.f)

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### Question #52 of 94

Question ID: 1462837

Which of the following ratios is a component of the original (three-part) DuPont equation?

- A) Asset turnover. 
- B) Gross profit margin. 
- C) Debt-to-equity ratio. 

### Explanation

The three-part DuPont approach is as follows: net profit margin  $\times$  asset turnover  $\times$  leverage ratio, where the leverage ratio is assets-to-equity. (Module 21.4, LOS 21.d)

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### Question #53 of 94

Question ID: 1457529

A firm's financial statements reflect the following:

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

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

	<u>Current Ratio</u>	<u>Quick Ratio</u>	<u>Cash Ratio</u>	
<b>A)</b>	1.1	0.8	0.6	✓
<b>B)</b>	0.8	0.6	1.1	✗
<b>C)</b>	1.1	0.6	0.8	✗

#### Explanation

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

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

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

(Module 21.2, LOS 21.b)

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#### Question #54 of 94

Question ID: 1457545

An analyst has gathered the following information about a company:

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

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

<b>A)</b>	0.7 days.	✗
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B) 1.4 days.



C) 252.7 days.



**Explanation**

$$\text{COGS} = (0.65)(\$1,000,000) = \$650,000$$

$$\text{Inventory turnover} = \text{COGS} / \text{Inventory} = \$650,000 / \$450,000 = 1.4444$$

$$\text{Average Inventory Processing Period} = 365 / 1.4444 = 252.7 \text{ days}$$

(Module 21.2, LOS 21.b)

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**Question #55 of 94**

Question ID: 1457569

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

A) 1 time.



B) 3 times.



C) 4 times.



**Explanation**

$$\text{ICR} = \text{operating profit} \div \text{I} = \text{EBIT} \div \text{I} = 100,000 \div 25,000 = 4$$

(Module 21.3, LOS 21.b)

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**Question #56 of 94**

Question ID: 1457581

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

A) 12 days.



B) 25 days.



C) 20 days.



**Explanation**

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

(Module 21.3, LOS 21.c)




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### Question #57 of 94

Question ID: 1457574

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

<u>Revenue / Average</u>	<u>Average total assets /</u>
<u>working capital</u>	<u>Average total equity</u>

- |                        |                 |   |
|------------------------|-----------------|---|
| A) Profitability ratio | Solvency ratio  |    |
| B) Activity ratio      | Solvency ratio  |    |
| C) Activity ratio      | Liquidity ratio |  |

#### Explanation

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

(Module 21.3, LOS 21.b)

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### Question #58 of 94

Question ID: 1457536

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

- |                       |   |
|-----------------------|---|
| A) Equity Turnover.   |  |
| B) Net Profit Margin. |  |
| C) Current Ratio.     |  |

#### Explanation

The current ratio is a liquidity measure. Equity turnover and net profit margin are used primarily as measures of a company's operating performance.

(Module 21.2, LOS 21.b)

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**Question #59 of 94**

Question ID: 1457546



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

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

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

What is the average receivables collection period?

A) 60.6 days.



B) 76.7 days.



C) 80.3 days.



#### Explanation

Average collection period =  $365 / \text{receivables turnover}$

Receivables turnover =  $\text{sales} / \text{average receivables} = 3,000 / 630 = 4.76$

Average receivables collection period =  $365 / 4.76 = 76.65$

(Module 21.2, LOS 21.b)

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### Question #60 of 94

Question ID: 1457530

An analyst has collected the following data about a firm:

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

What is the cash conversion cycle?

A) 56 days.



B) 26 days.



C) Not enough information is given.



#### Explanation

Cash conversion cycle =  $\text{receivables collection period} + \text{inventory processing period} - \text{payables payment period}$ .

Receivables collection period =  $(365 / 20) = 18$

Inventory processing period =  $(365 / 16) = 23$

Payables payment period =  $(365 / 24) = 15$

Cash conversion cycle =  $18 + 23 - 15 = 26$

(Module 21.2, LOS 21.b)

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### Question #61 of 94

Question ID: 1457585

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

A) \$120,000,000.



B) \$83,333,333.



C) \$1,200,000.



#### Explanation

One of the many ways ROE can be expressed is:  $ROE = \text{net income} / \text{equity}$

$$0.12 = \$10,000,000 / \text{equity}$$

$$\text{Equity} = \$10,000,000 / 0.12 = \$83,333,333$$

(Module 21.4, LOS 21.d)

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#### Question #62 of 94

Question ID: 1457605

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

A) \$22.0 million.



B) \$8.0 million.



C) \$8.8 million.



#### Explanation

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

(Module 21.5, LOS 21.g)

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#### Question #63 of 94

Question ID: 1457572

Given the following income statement:

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

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

	<u>Interest Coverage Ratio</u>	<u>Net Profit Margin</u>	
<b>A)</b>	2.63	0.30	
<b>B)</b>	0.57	0.56	
<b>C)</b>	7.67	0.30	

#### Explanation

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

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

(Module 21.3, LOS 21.b)

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

	12/31/20X4	12/31/20X3
<u>Assets</u>		
Cash	2,098	410
Accounts receivable	4,570	4,900
Inventory	4,752	4,500
Prepaid SGA	<u>877</u>	<u>908</u>
Total current assets	12,297	10,718
Land	0	4,000
Property, Plant & Equipment	11,000	11,000
Accumulated Depreciation	<u>(5,862)</u>	<u>(5,200)</u>
Total Assets	17,435	20,518
<u>Liabilities and Equity</u>		
Accounts Payable	4,651	5,140
Wages Payable	2,984	2,890
Dividends Payable	<u>100</u>	<u>100</u>
Total current liabilities	7,735	8,130
Long term Debt	1,346	7,388
Common Stock	4,000	4,000
Retained Earnings	<u>4,354</u>	<u>1,000</u>
Total Liabilities and Equity	17,435	20,518

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

	<u>Current ratio</u>	<u>Quick ratio</u>	
<b>A)</b> 1.48	0.86		✗
<b>B)</b> 1.59	0.86		✓
<b>C)</b> 1.59	1.59		✗

### Explanation

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

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

(Module 21.2, LOS 21.b)

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### Question #65 of 94

Question ID: 1457540

The following data apply to the XTC Company:

- Sales = \$1,000,000.
- Receivables = \$260,000.
- Payables = \$600,000.
- Purchases = \$800,000.
- COGS = \$800,000.
- Inventory = \$400,000.
- Net Income = \$50,000.
- Total Assets = \$800,000.
- Debt/Equity = 200%.

Which of the following statements about the company's activity ratios is *most* accurate? The company has:

**A)** 45 days of inventory on hand.



**B)** 95 days of sales outstanding.



**C)** 132 days of payables.



### Explanation

Receivables turnover =  $\$1,000,000 / \$260,000 = 3.840$

Days of sales outstanding =  $365 / 3.840 = 95.05$  days.

Inventory turnover =  $\$800,000 / \$400,000 = 2$

Days of inventory on hand =  $365 / 2 = 182.5$  days.

Payables turnover ratio =  $\$800,000 / \$600,000 = 1.333$ .

Number of days of payables =  $365 / 1.333 = 273.82$  days.

(Module 21.2, LOS 21.b)

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### Question #66 of 94

Question ID: 1457567

An analyst has gathered the following information about a firm:

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

What is this firm's operating profit margin?

A) 30%.



B) 50%.



C) 18%.



#### Explanation

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

(Module 21.3, LOS 21.b)

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### Question #67 of 94

Question ID: 1457523

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

A) \$12.0 million.



B) \$4.5 million.



C) \$7.5 million.



#### Explanation

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

(Module 21.2, LOS 21.b)

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### Question #68 of 94

Question ID: 1457604

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

Sales	100%
Cost of goods sold	<u>60%</u>
Gross profit	40%

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

- A) \$150 million increase.
- B) \$50 million increase.
- C) \$80 million increase.



#### Explanation

20X7 gross profit is equal to \$100 million ( $\$1 \times 250 \text{ million units sold} \times 40\% \text{ gross profit margin}$ ). The 10% price cut to \$0.90 will increase cost of goods sold to 67% of sales [ $\text{COGS} = 0.6(\$1) = \$0.60$ ;  $\$0.60 / \$0.90 = 67\%$ ]. As a result, gross profit will decrease to 33% of sales. If unit sales double in 20X8, gross profit will equal \$150 million ( $\$0.90 \times 500 \text{ million units} \times 33\% \text{ gross profit margin}$ ). Therefore, gross profit will increase \$50 million ( $\$150 \text{ million } 20\text{X}8 \text{ gross profit} - \$100 \text{ million } 20\text{X}7 \text{ gross profit}$ ).

(Module 21.5, LOS 21.g)

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#### Question #69 of 94

Question ID: 1457584

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

- A) \$40,000.
- B) \$360,000.
- C) \$36,000.



#### Explanation



The traditional DuPont system is given as:

$$\text{ROE} = (\text{net profit margin})(\text{asset turnover})(\text{leverage ratio})$$

Solving for the net profit margin yields:

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

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

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

$$0.04 = \text{net income} / \text{revenue} = \text{net income} / \$1,000,000$$

$$\$40,000 = \text{net income.}$$

(Module 21.4, LOS 21.d)

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### Question #70 of 94

Question ID: 1457551

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

	<u>Current ratio</u>	<u>Cash ratio</u>	
<b>A)</b> Increase	Increase		✗
<b>B)</b> No effect	Increase		✓
<b>C)</b> No effect	No effect		✗

#### Explanation

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

(Module 21.2, LOS 21.b)

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### Question #71 of 94

Question ID: 1462831

An analyst using vertical common-size analysis is *most likely* to express each item on an income statement as a percentage of:

A) sales.



B) operating income.



C) its value in a base period.



#### Explanation

Vertical common-size analysis of an income statement is typically done by stating each item as a percentage of sales. Stating each item on a financial statement as a percentage of its value in a base period is referred to as horizontal common-size analysis. (Module 21.1, LOS 21.a)

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#### Question #72 of 94

Question ID: 1457573

How are the quick ratio and the debt-to-capital ratio typically used when assessing a company's ability to meet its debt obligations?

A) Both are used primarily to assess its ability to meet long-term obligations.



B) Both are used primarily to assess its ability to meet short-term obligations.



C) One is used primarily to assess its ability to meet short-term obligations, and the other is used primarily to assess its ability to meet long-term obligations.



#### Explanation

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

(Module 21.3, LOS 21.b)

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#### Question #73 of 94

Question ID: 1457606

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




Description #1 – A computer generated analysis based on developing probability distributions of key variables that are used to drive the potential outcomes.

Description #2 – The process of analyzing the impact of future events by considering multiple key variables.

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

Sensitivity analysis

Scenario analysis

- |                          |                |   |
|--------------------------|----------------|---|
| <b>A)</b> Description #3 | Description #2 |  |
| <b>B)</b> Description #2 | Description #3 |  |
| <b>C)</b> Description #3 | Description #1 |  |

**Explanation**

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

(Module 21.5, LOS 21.g)

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**Question #74 of 94**

Question ID: 1457516

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

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

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

With respect to these statements:

- |                               |   |
|-------------------------------|---|
| <b>A)</b> both are correct.   |  |
| <b>B)</b> both are incorrect. |  |

C) only one is correct.



### Explanation

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

(Module 21.1, LOS 21.a)

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### Question #75 of 94

Question ID: 1457539

An analyst has gathered the following data about a company:

- Days' sales outstanding of 37 days.
- Days' payables of 30 days.
- Days of inventory on hand of 46 days.

What is their cash conversion cycle?

A) 45 days.



B) 113 days.



C) 53 days.



### Explanation

Cash conversion cycle = days of sales outstanding + days of inventory on hand – number of days of payables = 37 + 46 – 30 = 53 days.

(Module 21.2, LOS 21.b)

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### Question #76 of 94

Question ID: 1457518

Ratio analysis is most useful for comparing companies:

A) in different industries that use the same accounting standards.



B) of different size in the same industry.



C) that operate in multiple lines of business.



### Explanation

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

(Module 21.1, LOS 21.a)

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### Question #77 of 94

Question ID: 1457537

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

- A) Total asset turnover.
- B) Interest coverage.
- C) Current ratio.



### Explanation

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

(Module 21.2, LOS 21.b)

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### Question #78 of 94

Question ID: 1457524

An analyst gathered the following data about a company:

- Current liabilities are \$300.
- Total debt is \$900.
- Working capital is \$200.
- Capital expenditures are \$250.
- Total assets are \$2,000.
- Cash flow from operations is \$400.

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

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



### Explanation

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

(Module 21.2, LOS 21.b)

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### Question #79 of 94

Question ID: 1457587

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

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

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

Total Asset Turnover

Return on Equity

**A)** 1.25

20.8%



**B)** 1.33

15.8%



**C)** 1.33

20.8%



### Explanation

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

Return on equity = net income / average equity

Net income = EBIT – interest – taxes =  $800,000 - 160,000 - 256,000 = 384,000$

ROE =  $384,000 / 1,850,000 = 20.8\%$

(Module 21.4, LOS 21.d)

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**Question #80 of 94**

Question ID: 1457600

An analyst calculates the following data for three firms in an industry over the most recent 40 quarters:

	Sales		Net income	
	Mean	Std Dev	Mean	Std Dev
Jerome	1,200,000	400,000	120,000	80,000
Lawrence	3,500,000	700,000	400,000	300,000
Morris	6,400,000	1,600,000	800,000	400,000

Based only on these data, the analyst should conclude that, relative to the other two firms:

- A) Jerome has the least uncertainty about its net income. 
- B) Lawrence has the greatest uncertainty about its net income. 
- C) Morris has the greatest uncertainty about its sales. 

**Explanation**

Jerome CV sales =  $400,000 / 1,200,000 = 0.33$

Lawrence CV sales =  $700,000 / 3,500,000 = 0.20$

Morris CV sales =  $1,600,000 / 6,400,000 = 0.25$

Uncertainty about sales is greatest for Jerome and least for Lawrence.

Jerome CV net income =  $80,000 / 120,000 = 0.67$

Lawrence CV net income =  $300,000 / 400,000 = 0.75$

Morris CV net income =  $400,000 / 800,000 = 0.50$

Uncertainty about net income is greatest for Lawrence and least for Morris.

(Module 21.5, LOS 21.e)

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**Question #81 of 94**

Question ID: 1457525

An analyst has gathered the following information about a company:

### Balance Sheet

#### Assets

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

#### Liabilities and Equity

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

### Income Statement

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

What is the current ratio?

**A) 4.65.**





**B)** 2.67.



**C)** 0.22.



**Explanation**

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

(Module 21.2, LOS 21.b)

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**Question #82 of 94**

Question ID: 1457547

An analyst has gathered the following information about a company:

### Balance Sheet

#### *Assets*

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

#### *Liabilities and Equity*

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

### Income Statement

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

What is the receivables turnover ratio?

**A) 2.0.**



B) 1.0.



C) 0.5.



### Explanation

Receivables turnover =  $1,500(\text{sales}) / 750(\text{receivables}) = 2.0$

(Module 21.2, LOS 21.b)

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### Question #83 of 94

Question ID: 1457550

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

Accounts payable turnover 5.0

Cost of goods sold \$30 million

Average inventory \$3 million

Average receivables \$8 million

Total liabilities \$35 million

Interest expense \$2 million

Cash conversion cycle 13.5 days

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

A) \$58.4 million.



B) \$52.3 million.



C) \$57.8 million.



### Explanation

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

(Module 21.2, LOS 21.b)

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**Question #84 of 94**

Question ID: 1457579

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

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

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

**A)** 46 days.



**B)** 82 days.



**C)** 86 days.

**Explanation**

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

(Module 21.3, LOS 21.c)

**Question #85 of 94**

Question ID: 1462838

From the extended (5-part) DuPont equation, which of the following components describes the equation EBT / EBIT?

**A)** Tax burden.



**B)** Interest burden.



**C) Financial leverage.**



**Explanation**

EBT / EBIT is the interest burden, the second component in the extended DuPont equation. It shows that more leverage does not always lead to higher ROE. As leverage rises, so does the interest burden. The positive effects of leverage can be offset by the higher interest payments that accompany higher levels of debt. Net income / EBT is called the tax burden and is equal to  $(1 - \text{tax rate})$ . The higher the tax rate, the lower the ROE level. EBIT / revenue is called the EBIT margin or operating margin. (Module 21.4, LOS 21.d)

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An analyst has gathered the following information about a company:

### Balance Sheet

#### *Assets*

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

#### *Liabilities and Equity*

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

### Income Statement

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

Determine the current ratio and the cash ratio.

Current Ratio

Cash Ratio

A) 1.98                      1.86



B) 4.65                      0.93



C) 2.67                      1.07



### Explanation

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

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

(Module 21.2, LOS 21.b)

### Question #87 of 94

Question ID: 1457582



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

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

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

A) higher than G Company's because its interest coverage ratio is less than G Company's, but at least one-third of G Company's.



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

**Explanation**

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

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

(Module 21.3, LOS 21.c)

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

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

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

What is the operating profit margin?

A) 0.67.



B) 0.45.



C) 0.50.



#### Explanation

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

(Module 21.3, LOS 21.b)

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### Question #89 of 94

Question ID: 1457563

Given the following information about a firm:

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

The operating profit margin is *closest* to:

A) 10%.



B) 20%.



C) 40%.



#### Explanation

Operating profit margin = (\$1,000 revenues – \$600 COGS – \$200 operating expenses) / \$1,000 revenues = \$200 / \$1000 = 0.2

(Module 21.3, LOS 21.b)

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### Question #90 of 94

Question ID: 1457562

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

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

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

What is the gross profit margin?

A) 0.333.



B) 0.472.



C) 0.666.



#### Explanation

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

(Module 21.3, LOS 21.b)

### Question #91 of 94

Question ID: 1457602

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

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

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

A) Services and International.



B) International only.



C) Entertainment, Lodging, and Services.



#### Explanation

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

(Module 21.5, LOS 21.f)

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**Question #92 of 94**

Question ID: 1457589

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

A) 0.69.



B) 1.44.



C) 2.25.

**Explanation**

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

$$\text{ROE} = (\text{net profit margin})(\text{asset turnover})(\text{equity multiplier})$$

$$0.18 = (0.05)(2.5)(\text{equity multiplier})$$

$$0.18 \div [(0.05)(2.5)] = \text{equity multiplier}$$

$$0.18 \div 0.125 = \text{equity multiplier}$$

$$0.18 \div 0.125 = 1.44$$

(Module 21.4, LOS 21.d)

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**Question #93 of 94**

Question ID: 1457588

With other variables remaining constant, if a firm's asset turnover increases, its return on equity:

A) may increase, decrease, or remain the same.



B) will decrease.



C) will increase.

**Explanation**

The DuPont decomposition ( $\text{ROE} = \text{net profit margin} \times \text{asset turnover} \times \text{leverage ratio}$ ) shows that ROE will increase if asset turnover increases, assuming net profit margin and leverage are unchanged.


(Module 21.4, LOS 21.d)

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**Question #94 of 94**

Question ID: 1457554

If the quick ratio is equal to 2.0, a decrease in inventory and an equal decrease in accounts payable will:

- A)** increase the quick ratio. 
- B)** decrease the quick ratio. 
- C)** leave the quick ratio unchanged. 

**Explanation**

The quick ratio numerator is cash plus marketable securities plus accounts receivable, and the denominator is current liabilities. The numerator is unaffected by a change in inventory, while the denominator decreases with a decrease in accounts payable, so the quick ratio will increase.

(Module 21.2, LOS 21.b)