Student name:\_\_\_\_\_\_\_\_\_\_

**MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.  
1)** Which of the following is a company *least* likely required to present according to International Accounting Standard (IAS) No. 1?

1) \_\_\_\_\_\_

A) Statement of changes in owners’ equity.   
 B) A summary of accounting policies.  
 C) Disclosures of material events.

**2)** According to IFRS guidance for management’s commentary, addressing the company’s key relationships is:

2) \_\_\_\_\_\_

A) neither recommended nor required.   
 B) required.  
 C) recommended.

**3)** Selected information from Able Company’s financial activities is as follows:  
 ● Net Income was $720,000.  
 ● 1,000,000 shares of common stock were outstanding on January 1.  
 ● 1,000 shares of 8%, $1,000 par value preferred shares were outstanding on January 1.  
 ● The tax rate was 40%.  
 ● The average market price per share for the year was $20.  
 ● 6,000 shares of 3%, $500 par value preferred shares, convertible into common shares at a rate of 40 common shares for each preferred share, were outstanding for the entire year.  
   
 Able’s basic and diluted earnings per share (EPS) are *closest* to:

|  |  |  |
| --- | --- | --- |
|  | **Basic EPS** | **Diluted EPS** |
| **A)** | $0.64 | $0.64 |
| **B)** | $0.55 | $0.52 |
| **C)** | $0.55 | $0.55 |

3) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**4)** A company has the following sequence of events regarding their stock:  
 ● One million shares outstanding at the beginning of the year.  
 ● On June 30th, they declared and issued a 10% stock dividend.  
 ● On September 30th, they sold 400,000 shares of common stock at par. Basic earnings per share at year-end will be computed on how many shares?

4) \_\_\_\_\_\_

A) 1,200,000.   
 B) 1,000,000.  
 C) 1,100,000.

**5)** Books Forever, Incorporated, 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?

5) \_\_\_\_\_\_

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

**6)** David Chance, CFA, is analyzing Grow Corporation. Chance gathers the following information:

|  |  |
| --- | --- |
| **Net cash provided by operating activities** | $ 3,500 |
| **Net cash used for fixed capital investments** | $ 727 |
| **Cash paid for interest** | $ 195 |
| **Income before tax** | $ 4,400 |
| **Income tax expense** | $ 1,540 |
| **Net income** | $ 2,860 |

Grow’s free cash flow to the firm (FCFF) is *closest* to:

6) \_\_\_\_\_\_

A) $2,900.   
 B) $2,260.  
 C) $2,640.

**7)** The following footnote appeared in Crabtree Company’s 20X7 annual report:  
   
 *“On December 31, 20X7, Crabtree recognized a restructuring charge of $20 million, of which $5 million was for severance pay for employees who will be terminated in 20X8 and $15 million was for land that became permanently impaired in 20X7.”*  
   
 Based only on these changes, Crabtree’s net profit margin and fixed asset turnover ratio (using year- end financial statement values) in 20X8 as compared to 20X7 will be:

|  |  |  |
| --- | --- | --- |
|  | **Net profit margin** | **Fixed asset turnover** |
| **A)** | Lower | Higher |
| **B)** | Higher | Unchanged |
| **C)** | Higher | Higher |

7) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**8)** Do the following characteristics have to be met in order to classify a liability as current on the balance sheet?  
   
 Characteristic #1 – Settlement is expected within one year or operating cycle, whichever is less.  
   
 Characteristic #2 – Settlement will require the use of cash within one year or operating cycle, whichever is greater.

|  |  |  |
| --- | --- | --- |
|  | **Characteristic #1** | **Characteristic #2** |
| **A)** | No | No |
| **B)** | Yes | No |
| **C)** | No | Yes |

8) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

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

9) \_\_\_\_\_\_

A) Sale of held-to-maturity securities for cash.   
 B) Purchase of plant and equipment used in the manufacturing process with financing provided by the seller.  
 C) Principal payments received from loans made to others.

**10)** 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.

10) \_\_\_\_\_\_

A) 2.89.   
 B) 3.25.  
 C) 3.71.

**11)**

|  |  |
| --- | --- |
| McQueen Corporation prepared the following common-size income statement for the year ended | |
| December 31, 20X7: | |
| **Sales** | 100% |
| **Cost of goods sold** | 60% |
| **Gross profit** | 40% |

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

11) \_\_\_\_\_\_

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

**12)** 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 | Lower |
| **B)** | Higher | Higher |
| **C)** | Lower | Higher |

12) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**13)** A segment of a common-size balance sheet for Olsen Company in its most recent year shows the following data:

|  |  |
| --- | --- |
| **Common stock** | 1% |
| **Additional paid-in capital** | 19% |
| **Preferred stock** | 15% |

How should an analyst most appropriately interpret these data?

13) \_\_\_\_\_\_

A) Proceeds from the issuance of common stock are 20% of total assets.   
 B) Shareholders’ equity is 35% of total assets.  
 C) Preferred stock is 15% of shareholders’ equity.

**14)** Orange Company’s net income for 2004 was $7,600,000 with 2,000,000 shares outstanding. The average share price in 2004 was $55. Orange had 10,000 shares of eight percent $1,000 par value convertible preferred stock outstanding since 2003. Each preferred share was convertible into 20 shares of common stock. Orange Company’s diluted earnings per share (Diluted EPS) for 2004 is *closest* to:

14) \_\_\_\_\_\_

A) $3.80.   
 B) $3.45.  
 C) $3.40.

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

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

15) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

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

|  |  |  |
| --- | --- | --- |
| **Gain on sale of equipment** | $ 6,000 |  |
| **Proceeds from sale of equipment** | 10,000 |  |
| **Purchase of Zip Company bonds for** | 180,000 | (maturity value $200,000) |
| **Amortization of bond discount** | 2,000 |  |
| **Dividends paid** | (75,000) |  |
| **Proceeds from sale of Treasury stock** | 38,000 |  |

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

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

16) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**17)** According to International Financial Reporting Standards, how do cash dividends received from trading securities and financial securities measured at fair value through OCI affect net income?

|  |  |  |
| --- | --- | --- |
|  | **Trading securities** | **Fair value through OCI** |
| **A)** | No effect | Increase |
| **B)** | Increase | No effect |
| **C)** | Increase | Increase |

17) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**18)** The following data pertains to the Sapphire Company:  
 ● Net income equals $15,000.  
 ● 5,000 shares of common stock issued on January 1st.  
 ● 10% stock dividend issued on June 1st.  
 ● 1,000 shares of common stock were repurchased on July 1st.  
 ● 1,000 shares of 10%, $100 par preferred stock each convertible into 8 shares of common were outstanding the whole year.  
   
 What is the company’s diluted earnings per share (EPS)?

18) \_\_\_\_\_\_

A) $2.50.   
 B) $1.00.  
 C) $1.15.

**19)** Duster Company reported the following financial information at the end of 2007:

|  |  |
| --- | --- |
|  | ***in millions*** |
| **Unearned revenue** | $ 240 |
| **Common stock at par** | 30 |
| **Capital in excess of par** | 440 |
| **Accounts payable** | 1,150 |
| **Treasury stock** | 2,000 |
| **Retained earnings** | 5,160 |
| **Accrued expenses** | 830 |
| **Accumulated other comprehensive loss** | 210 |
| **Long-term debt** | 1,570 |

Calculate Duster’s liabilities and stockholders’ equity as of December 31, 2007.

|  |  |  |
| --- | --- | --- |
|  | **Liabilities** | **Stockholders' equity** |
| **A)** | $3,790 million | $3,420 million |
| **B)** | $3,550 million | $7,840 million |
| **C)** | $3,790 million | $7,420 million |

19) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**20)** Matrix, Incorporated’s common size income statement for the years ended December 31, 20X1 and 20X2 included the following information (percent of net sales):

|  |  |  |
| --- | --- | --- |
|  | **20X1** | **20X2** |
| **Sales** | 100 | 100 |
| **Cost of Goods Sold** | (55) | (60) |
|  | 45 | 40 |
| **Selling General & Administrative** | (5) | (5) |
| **Depreciation** | (7) | (8) |
|  | 33 | 27 |
| **Interest Expense** | (15) | (6) |
|  | 18 | 21 |
| **Income Tax Expense** | (6) | (7) |
|  | 12 | 14 |

Analysis of this data indicates that from 20X1 to 20X2:

20) \_\_\_\_\_\_

A) the effective tax rate increased.   
 B) interest expense per dollar of sales declined.  
 C) cost of goods sold increased.

**21)** Convenience Travel Corporation’s financial information for the year ended December 31, 20X4 included the following:

|  |  |
| --- | --- |
| **Property Plant & Equipment** | $15,000,000 |
| **Accumulated Depreciation** | 9,000,000 |

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

21) \_\_\_\_\_\_

A) $8,000,000.   
 B) $11,000,000.  
 C) $13,000,000.

**22)** Joplin Corporation reports the following in its year-end financial statements:  
 ● Net income of $43.7 million.  
 ● Depreciation expense of $4.2 million.  
 ● Increase in accounts receivable of $1.5 million.  
 ● Decrease in accounts payable of $2.3 million.  
 ● Increase in capital stock of $50 million.  
 ● Sold equipment with a book value of $7 million for $15 million after-tax.  
 ● Purchased equipment for $35 million.  
   
 Joplin’s free cash flow to the firm (FCFF) is closest to:

22) \_\_\_\_\_\_

A) $66 million.   
 B) $24 million.  
 C) $16 million.

**23)** What is the appropriate measurement basis for equipment used in the manufacturing process?

23) \_\_\_\_\_\_

A) Historical cost   
 B) Fair value  
 C) Lower of cost or net realizable value

**24)** Financial information for Jefferson Corporation for the year ended December 31st, was as follows:

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

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

24) \_\_\_\_\_\_

A) $1,200,000.   
 B) $900,000.  
 C) $800,000.

**25)** A firm’s balance sheet prepared under IFRS is *least likely* to include:

25) \_\_\_\_\_\_

A) market value of inventory.   
 B) fair value of firm PPE.  
 C) market value of the firm’s equity.

**26)** Is an acquisition of treasury stock or a loss from the write-down of inventory under the lower-of-cost-or- market rule included in comprehensive income?

|  |  |  |
| --- | --- | --- |
|  | **Inventory write-down** | **Acquisition of treasury stock** |
| **A)** | No | No |
| **B)** | No | Yes |
| **C)** | Yes | No |

26) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

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

27) \_\_\_\_\_\_

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

**28)** A company reports a gain of €100,000 on the sale of an asset and a loss of €100,000 due to foreign currency translation adjustment. Which of these items will be included in the company’s comprehensive income?

28) \_\_\_\_\_\_

A) Only one of these items is included in comprehensive income.   
 B) Both of these items are included in comprehensive income.  
 C) Neither of these items is included in comprehensive income.

**29)** An analyst compiled the following information for Universe, Incorporated for the year ended December 31, 20X4:  
 ● Net income was $850,000.  
 ● Depreciation expense was $200,000.  
 ● Common stock was sold for $100,000.  
 ● Preferred stock (eight percent annual dividend) was sold at par value of $125,000.  
 ● Common stock dividends of $25,000 were paid.  
 ● Preferred stock dividends of $10,000 were paid.  
 ● Equipment with a book value of $50,000 was sold for $100,000.  
   
 Using the indirect method and assuming U.S. GAAP, what was Universe Incorporated’s cash flow from operations (CFO) for the year ended December 31, 20X4?

29) \_\_\_\_\_\_

A) $1,000,000.   
 B) $1,050,000.  
 C) $1,015,000.

**30)** 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 Statement** | **%** |
| **Income tax** | 5.7 |
| **Net income** | 5.2 |

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

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

|  |  |  |
| --- | --- | --- |
|  | **Current ratio** | **Return on equity** |
| **A)** | 2.4 | 24.5% |
| **B)** | 4.6 | 25.2% |
| **C)** | 2.4 | 26.8% |

30) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**31)** The following information is for Trotters Diversified as of year-end:  
 ● Average common shares outstanding of 5.0 million.  
 ● Average market price for common stock of $35.00 per share.  
 ● Net income of $9.0 million.  
 ● Common stock dividends paid of $1.2 million.  
 ● Tax rate of 40%.  
 ● 500,000 shares of cumulative convertible preferred stock with $30 par value and 10% dividend. Each preferred share is convertible into 5 common shares. Preferred dividends of $1.5 million were paid.  
 ● 10,000 convertible $1,000 par bonds with a 6.0% coupon, each convertible into 8 shares of common stock.  
 ● 400,000 stock options with an exercise price of $32.00 per share.  
   
 All of these securities were outstanding for the full year. Diluted EPS for Trotters Diversified is *closest* to:

31) \_\_\_\_\_\_

A) $1.19.   
 B) $1.23.  
 C) $1.50.

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

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

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

|  |  |  |
| --- | --- | --- |
|  | **Direct method** | **Indirect method** |
| **A)** | $34,000 | $34,000 |
| **B)** | $31,000 | $34,000 |
| **C)** | $31,000 | $31,000 |

32) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

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

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

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

33) \_\_\_\_\_\_

A) −$300,000.   
 B) −$500,000.  
 C) −$400,000.

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

34) \_\_\_\_\_\_

A) $2,200.   
 B) $1,000.  
 C) $1,200.

**35)** Galaxy Corporation manufactures custom motorcycles. Galaxy finances the motorcycles over 36 months for customers who make a minimum down payment of 10%. Historically, Galaxy has experienced bad debt losses equal to 1% of sales. Galaxy also provides a 24 month unlimited warranty on all new motorcycles. In the past, warranty expense has averaged 3% of sales. Ignoring taxes, how does the recognition of bad debt expense and warranty expense at the time of sale affect Galaxy’s liabilities?

|  |  |  |
| --- | --- | --- |
|  | **Bad debt expense** | **Warranty expense** |
| **A)** | No effect | No effect |
| **B)** | No effect | Increase |
| **C)** | Increase | No effect |

35) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**36)** A 12 percent $100,000 convertible bond was issued on October 1, 2004. It is dilutive and can be converted into 18,000 shares. The effective income tax rate for the year was 40%. What adjustments should be made to calculate diluted earnings per share?

|  |  |  |
| --- | --- | --- |
|  | **Interest added to the numerator** | **Shares added to the denominator** |
| **A)** | $3,000 | 18,000 |
| **B)** | $3,000 | 4,500 |
| **C)** | $1,800 | 4,500 |

36) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**37)** Holden Company’s fixed asset footnote included the following:  
 ● During 20X7, Holden sold machinery for a gain of $100,000. The machinery had an original cost of $500,000 and its accumulated depreciation was $240,000.  
 ● At the end of 20X7, Holden purchased machinery at a cost of $1,000,000. Holden paid $400,000 cash. The balance was financed by the seller at 8% interest.  
 ● Depreciation expense was $2,080,000 for the year ended 20X7.  
   
 Calculate Holden’s cash flow from investing activities for the year ended 20X7.

37) \_\_\_\_\_\_

A) $300,000 outflow.   
 B) $40,000 outflow.  
 C) $360,000 inflow.

**38)** A company reports the following unusual events:  
 ● Loss on discontinued operations.  
 ● Restructuring and severance costs applicable to asset sales.  
 ● Plant shutdown costs.  
   
 Which of these items would *most likely* be considered nonrecurring and included in operating income?

38) \_\_\_\_\_\_

A) Loss on discontinued operations and restructuring and severance costs applicable to asset sales.   
 B) Restructuring and severance costs applicable to asset sales and plant shutdown costs.  
 C) Loss on discontinued operations and plant shutdown costs.

**39)** Red Oak Corporation is a furniture manufacturer located in Canada. Red Oak is financed with a combination of debt and equity. The debt consists of unsecured zero-coupon bonds that mature in 20 years. For income tax purposes, interest on the bonds is deductible when accrued. Red Oak’s equity consists of common stock and preferred stock. No dividends have ever been paid on Red Oak’s common stock; however, dividends are paid quarterly to the preferred shareholders. Should the accrued interest on the zero-coupon bonds and the dividends paid to the preferred shareholders be reported as a nonoperating component of Red Oak’s net income?

|  |  |  |
| --- | --- | --- |
|  | **Accrued interest** | **Preferred dividends** |
| **A)** | Yes | Yes |
| **B)** | Yes | No |
| **C)** | No | Yes |

39) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**40)** Selected information from Feder Corporation’s financial activities for the year is as follows:  
 ● Net income was $7,650,000.  
 ● 1,100,000 shares of common stock were outstanding on January 1.  
 ● The average market price per share was $62.  
 ● Dividends were paid during the year.  
 ● The tax rate was 40%.  
 ● 10,000 shares of 6% $1,000 par value preferred shares convertible into common shares at a rate of 20 common shares for each preferred share were outstanding for the entire year.  
 ● 70,000 options, which allow the holder to purchase 10 shares of common stock at an exercise price of $50 per common share, were outstanding the entire year.  
   
 Feder Corporation’s diluted earnings per share (EPS) was *closest* to:

40) \_\_\_\_\_\_

A) $5.32.   
 B) $5.87.  
 C) $4.91.

**41)** Consider the following:  
   
 Statement #1: One approach to presenting a common-size cash flow statement is to express each inflow of cash as a percentage of total cash inflows and each outflow of cash as a percentage of total cash outflows.  
   
 Statement #2: Expressing each line item of the cash flow statement as a percentage of revenue is useful in forecasting future cash flows.  
   
 Which of these statements regarding a common-size cash flow statement is (are) CORRECT?

41) \_\_\_\_\_\_

A) Only statement #1 is correct.   
 B) Both statements are correct.  
 C) Only statement #2 is correct.

**42)** 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:

42) \_\_\_\_\_\_

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

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

43) \_\_\_\_\_\_

A) total cash outflows for the period.   
 B) revenues for the period.  
 C) operating cash flow for the period.

**44)** The First National Bank is a commercial bank that specializes in consumer financing, particularly automobile loans. The majority of the loans are funded from customer deposits. In addition, the bank purchases various investment securities with available cash. The investments are debt securities and have an average maturity date of less than 30 days. Should First National Bank report the interest received from the consumer loans and the interest received from the investment securities as an operating or as a nonoperating component in its year-end income statement?

|  |  |  |
| --- | --- | --- |
|  | **Consumer loans** | **Investment securities** |
| **A)** | Nonoperating | Operating |
| **B)** | Operating | Nonoperating |
| **C)** | Operating | Operating |

44) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**45)** Young Distributors, Incorporated issued convertible bonds two years ago, and those bonds are the only potentially dilutive security Young has issued. In 20X5, Young’s basic earnings per share (EPS) and diluted EPS were identical, but in 20X4 they were different. Which of the following factors is *least likely* to explain the difference between basic and diluted EPS? The:

45) \_\_\_\_\_\_

A) bonds were antidilutive in 20X5 but not in 20X4.   
 B) bonds were redeemed by Young Distributors at the beginning of 20X5.  
 C) average market price of Young common stock increased in 20X5.

**46)** 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*?

46) \_\_\_\_\_\_

A) Gross profit margin has improved.   
 B) Leverage has declined.  
 C) Return on equity has improved.

**47)** 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:

47) \_\_\_\_\_\_

A) may shorten or lengthen.   
 B) lengthens.  
 C) shortens.

**48)** An analyst compiled the following information from Hampshire, Incorporated’s financial activities in the most recent year:  
 ● Net income was $2,800,000.  
 ● 100,000 shares of common stock were outstanding on January 1.  
 ● The average market price per share for the year was $250.  
 ● 10,000 shares of 6%, $1,000 par value preferred shares were outstanding the entire year.  
 ● 10,000 warrants, which allow the holder to purchase 10 shares of common stock for each warrant held at a price of $150 per common share, were outstanding the entire year.  
 ● 30,000 shares of common stock were issued on September 1.  
   
 Hampshire, Incorporated’s diluted earnings per share are *closest* to:

48) \_\_\_\_\_\_

A) $14.67.   
 B) $18.38.  
 C) $20.00.

**49)** Selected information from Gerrard, Incorporated’s financial activities in the most recent year was as follows:  
 ● Net income was $330,000.  
 ● The tax rate was 40%.  
 ● 700,000 shares of common stock were outstanding on January 1.  
 ● The average market price per share for the year was $6.  
 ● Dividends were paid during the year.  
 ● 2,000 shares of 8% $500 par value preferred shares, convertible into common shares at a rate of 200 common shares for each preferred share, were outstanding for the entire year.  
 ● 200,000 shares of common stock were issued on March 1.  
   
 Gerrard, Incorporated’s diluted earnings per share (diluted EPS) was *closest* to:

49) \_\_\_\_\_\_

A) $0.261.   
 B) $0.289.  
 C) $0.197.

**50)** 50*.* Which of the following statements about a firm with convertible preferred stock outstanding is *most* accurate?

50) \_\_\_\_\_\_

A) If diluted EPS is less than basic EPS then the convertible preferred is said to be antidilutive.   
 B) Diluted EPS is calculated with net income minus preferred dividends in the numerator.  
 C) If diluted and basic EPS are equal, the firm must report both basic and diluted EPS.

**51)** Barracuda Corporation, a U.S. corporation, owns a subsidiary located in Germany. The German subsidiary’s financial statements are maintained in euros. If the euro recently appreciated relative to the U.S. dollar, how would the unrealized translation gain affect Barracuda’s retained earnings and total stockholders’ equity?

|  |  |  |
| --- | --- | --- |
|  | **Retained earnings** | **Total stockholders' equity** |
| **A)** | No effect | No effect |
| **B)** | No effect | Increase |
| **C)** | Increase | Increase |

51) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**52)** The “All Faiths” church is building a new church for $2 million on land acquired several years ago. The contractor estimates the cost at $1.3 million and the project is to be completed over a 2-year period with the payments split evenly between the 2 years. During the first year, the total costs incurred were $700,000. During the second year the contractor experienced cost overruns and costs incurred were $1.0 million. How much revenue and income should the contractor recognize in the second year of the project?

|  |  |  |
| --- | --- | --- |
|  | **Revenue** | **Income** |
| **A)** | $ 923,077 | −$ 76,923 |
| **B)** | $ 1,076,923 | $ 376,923 |
| **C)** | $ 1,000,000 | $ 0 |

52) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**53)** Jodi Lein, small business consultant, is currently working with RJ Landscaping, a sole proprietorship. She is trying to educate the owner on the importance of monitoring cash flows. Operating information as of the end of the most recent month appears below:  
 ● Cash from sale of truck of $7,000.  
 ● Cash salaries paid of $17,000.  
 ● Cash from customers of $45,000.  
 ● Depreciation expense of $5,500.  
 ● Interest on bank line of credit of $1,000.  
 ● Cash paid to suppliers of $22,000.  
 ● Other cash expenses, including rent, of $6,300.  
 ● No taxes due.  
   
 Using this information and U.S. GAAP, what is the cash flow from operations for the month?

53) \_\_\_\_\_\_

A) −$1,300.   
 B) $11,200.  
 C) −$300.

**54)** Which costs are *least likely* to be reported as an expense in the current accounting period?

54) \_\_\_\_\_\_

A) Period costs.   
 B) Loan interest that has not yet been paid.  
 C) Costs of producing inventory.

**55)** Determine the cash flow from operations given the following table.

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

55) \_\_\_\_\_\_

A) $20.   
 B) $45.  
 C) $35.

**56)** For a manufacturing company reporting under U.S. GAAP, interest received is *most likely* reported as:

56) \_\_\_\_\_\_

A) an investing cash flow and as non-operating income.   
 B) an operating cash flow but as non-operating income.  
 C) both an operating cash flow and operating income.

**57)** Which costs are *least likely* to be reported as an expense in the current accounting period?

57) \_\_\_\_\_\_

A) Period costs.   
 B) Loan interest that has not yet been paid.  
 C) Costs of producing inventory.

**58)** A U.S. GAAP reporting company invests $50 million in a bond portfolio yielding 4% with an average maturity of seven years. After one year, interest rates have fallen by 50 basis points. The company will report the highest retained earnings if the securities in the portfolio are classified as:

58) \_\_\_\_\_\_

A) trading securities.   
 B) available-for-sale.  
 C) held-to-maturity.

**59)** From Thorpe Company’s cash flow statement, an analyst discovers that during the most recent period Thorpe spent $2 million on what the firm describes as “investment in capital improvements.” If the analyst believes this expenditure will not give Thorpe any enduring benefit beyond the current period, the *most appropriate* adjustment is to:

59) \_\_\_\_\_\_

A) decrease both CFO and CFI.   
 B) increase CFO and decrease CFI.  
 C) decrease CFO and increase CFI.

**60)** A common-size cash flow statement is *least likely* to show each cash inflow as a percentage of:

60) \_\_\_\_\_\_

A) revenue.   
 B) total cash flows.  
 C) all cash inflows.

**61)** Which of the following items would affect owners’ equity and also appear on the income statement?

61) \_\_\_\_\_\_

A) Unrealized gains and losses on available-for-sale securities.   
 B) Dividends paid to shareholders.  
 C) Unrealized gains and losses on trading securities.

**62)** The revaluation model for investment property is permitted under:

62) \_\_\_\_\_\_

A) both IFRS and U.S. GAAP.   
 B) neither IFRS nor U.S. GAAP.  
 C) IFRS, but not U.S. GAAP.

**63)** Train, Incorporated’s cash flow from operations (CFO) in 20X8 was $14 million. Train paid $8 million cash to acquire a franchise at the beginning of 20X8 that was expensed in 20X8. If Train had elected to amortize the cost of the franchise over eight years, 20X8 cash flow from operations (CFO) would have been:

63) \_\_\_\_\_\_

A) $21 million.   
 B) $14 million.  
 C) $22 million.

**64)** A manufacturing firm shuts down production at one of its plants and offers the facility for rent. Based on the market for similar properties, the firm determines that the fair value of the plant is €500,000 more than its carrying value. If this firm uses the cost model for plant and equipment and the fair value model for investment property, should it recognize a gain on its income statement?

64) \_\_\_\_\_\_

A) No, because the firm must continue to use the cost model for valuation of this asset.   
 B) Yes, because the plant will be reclassified as investment property.  
 C) No, because the increase in value does not reverse a previously recognized loss.

**65)** A firm acquires investment property for €3 million and chooses the fair value model for financial reporting. In Year 1 the market value of the investment property decreases by €150,000. In Year 2 the market value of the investment property increases by €200,000. On its financial statements for Year 2, the firm will recognize a:

65) \_\_\_\_\_\_

A) €150,000 increase in shareholders’ equity.   
 B) €200,000 gain on its income statement.  
 C) €150,000 gain on its income statement and a €50,000 revaluation surplus in shareholders’ equity.

**66)** For a company which owns a majority of the equity of a subsidiary, whether to create a deferred tax liability for undistributed profits from the subsidiary depends on an “indefinite reversal criterion” under:

66) \_\_\_\_\_\_

A) U.S. GAAP, but not IFRS.   
 B) both IFRS and U.S. GAAP.  
 C) IFRS, but not U.S. GAAP.

**67)** Diabelli Incorporated is a manufacturing company that is operating at normal capacity levels. Which of the following inventory costs is *most likely* to be recognized as an expense on Diabelli’s financial statements when the inventory is sold?

67) \_\_\_\_\_\_

A) Selling cost.   
 B) Administrative overhead.  
 C) Allocation of fixed production overhead.

**68)** Christophe Incorporated is an electronics manufacturing firm. It owns equipment with a tax basis of $800,000 and a carrying value of $600,000 as the result an impairment charge. It also has a tax loss carryforward of $300,000 that is expected to be utilized within the next year or two. The tax rate on these items is 40% but the tax rate will decrease to 35%. Which of the following is *closest to* the effect on the income statement of the change in tax rate?

68) \_\_\_\_\_\_

A) Decrease income tax expense by $5,000.   
 B) Increase income tax expense by $5,000.  
 C) Increase income tax expense by $25,000.

**69)** A tax rate that has been substantively enacted is used to determine the balance sheet values of deferred tax assets and deferred tax liabilities under:

69) \_\_\_\_\_\_

A) both IFRS and U.S. GAAP.   
 B) IFRS only.  
 C) U.S. GAAP only.

**70)** A company issues 5% semiannual coupon, 3-year, $1,000 par value bonds on January 1, 20X0, when the market interest rate is 13.3%. The sale proceeds are $800. Under the effective interest rate method, what amount of interest expense per $1,000 par value will the company record for the year ending December 31, 20X1?

70) \_\_\_\_\_\_

A) $106.40.   
 B) $116.29.  
 C) $66.29.

**71)** For a firm that uses the cost basis for valuing its long-lived assets, fair value is a consideration when calculating a gain or loss on:

71) \_\_\_\_\_\_

A) selling an asset.   
 B) abandoning an asset.  
 C) exchanging an asset.

**72)** The inventory turnover ratio and the number of days in inventory are *least likely* used to evaluate the:

72) \_\_\_\_\_\_

A) age of a firm's inventory.   
 B) effectiveness of a firm's inventory management.  
 C) stability of a firm's inventory levels.

**73)** Which of the following statements regarding the disclosure of deferred taxes in a company’s balance sheet is *most* accurate?

73) \_\_\_\_\_\_

A) Current deferred tax liability and noncurrent deferred tax asset are netted, resulting in the disclosure of a net noncurrent deferred tax liability or asset.   
 B) There should be a combined disclosure of all deferred tax assets and liabilities that are likely to reverse in the current period.  
 C) Deferred tax assets and liabilities are classified as noncurrent.

**74)** Which set of accounting standards requires firms to disclose estimated amortization expense for the next five years on intangible assets?

74) \_\_\_\_\_\_

A) U.S. GAAP.   
 B) Both IFRS and U.S. GAAP.  
 C) IFRS.

**75)** Which of the following factors is *least likely* to cause a difference between a firm’s effective tax rate and statutory rate?

75) \_\_\_\_\_\_

A) Tax credits.   
 B) Non-deductible expenses.  
 C) Deductible expenses.

**76)** When bonds are issued at a premium:

76) \_\_\_\_\_\_

A) earnings of the firm increase over the life of the bond as the bond premium is amortized.   
 B) coupon interest paid decreases each period as bond premium is amortized.  
 C) earnings of the firm decrease over the life of the bond as the bond premium is amortized.

**77)** Under which financial reporting standards is the full amount of a deferred tax asset shown on the balance sheet, regardless of its probability of being realized fully?

77) \_\_\_\_\_\_

A) IFRS, but not U.S. GAAP.   
 B) U.S. GAAP, but not IFRS.  
 C) Neither IFRS nor U.S. GAAP.

**78)** Barber Incorporated, which uses LIFO inventory accounting under U.S. GAAP, sells DVD recorders. On October 14, it purchased a large number of recorders at a cost of $90 each. Due to an oversupply of recorders remaining in the marketplace due to lower than anticipated demand during the Christmas season, the selling price at December 31 is $80 and the replacement cost is $73. The normal profit margin is 5 percent of the selling price and the selling costs are $2 per recorder. What is the value of the recorders on December 31?

78) \_\_\_\_\_\_

A) $78.   
 B) $73.  
 C) $74.

**79)** Selected information from the financial statements of Salvo Company for the years ended December 31, 20X3 and 20X4 is as follows (in $ millions):

|  |  |  |
| --- | --- | --- |
|  | **20X3** | **20X4** |
| **Sales** | $ 21 | $ 23 |
| **Cost of Goods Sold** | (8) | (9) |
| **Gross Profit** | 13 | 14 |
| **Cost of Franchise** | (6) | 0 |
| **Other Expenses** | (6) | (6) |
| **Net Income** | $ 1 | $ 8 |
| **Cash** | $ 4 | $ 5 |
| **Accounts Receivable** | 6 | 5 |
| **Inventory** | 9 | 7 |
| **Property, Plant & Equipment (net)** | 12 | 15 |
| **Total Assets** | $ 31 | $ 32 |
| **Accounts Payable** | $ 7 | $ 5 |
| **Long-term Debt** | 10 | 5 |
| **Common Stock** | 8 | 8 |
| **Retained Earnings** | 6 | 14 |
| **Total Liabilities and Equity** | $ 31 | $ 32 |

If Salvo had amortized the cost of the franchise acquired in 20X3 over six years instead of expensing it, Salvo’s return on average total equity for 20X4 would have been *closest* to:

79) \_\_\_\_\_\_

A) 31.1%.   
 B) 35.6%.  
 C) 38.9%.

**80)** Under U.S. GAAP, a lessee must recognize a balance sheet liability for:

80) \_\_\_\_\_\_

A) finance leases, but not operating leases.   
 B) operating leases, but not finance leases.  
 C) both finance leases and operating leases.

**81)** Cushinson Corporation had a beginning inventory of $9,500 (250 units) and made three inventory purchases during the fiscal year:

|  |  |  |
| --- | --- | --- |
|  | **Purchases** | **Units Total Cost** |
| **3/1/X6** | 400 | $ 14,800 |
| **7/1/X6** | 450 | $ 14,850 |
| **9/1/X6** | 550 | $ 15,950 |

The company began operations on Jan. 1, 20X6. Costing uses the LIFO method of determining cost of goods sold. First year sales were 1,300 units. The *most likely* effects of using LIFO inventory costing as compared to FIFO in Cushinson’s 20X6 financial statements are:

81) \_\_\_\_\_\_

A) lower net income; lower working capital.   
 B) higher net income; higher working capital.  
 C) higher net income; lower working capital.

**82)** A reconciliation of beginning and ending carrying values for each class of property, plant, and equipment is required for firms reporting under:

82) \_\_\_\_\_\_

A) U.S. GAAP.   
 B) both U.S. GAAP and IFRS.  
 C) IFRS.

**83)** An IFRS-reporting firm reclassifies a building it owns from “owner-occupied” to “investment property.” The fair value of the building is greater than its carrying value. Under the fair value model for investment property, the firm will recognize a gain:

83) \_\_\_\_\_\_

A) in other comprehensive income but not on the income statement.   
 B) only if it reverses a previously recognized loss.  
 C) equal to the difference between fair value and carrying value.

**84)** Alter Incorporated determines that it has $35,000 of accounts receivable outstanding at the end of 20X8. Based on past experience, it recognizes an allowance for bad debt equal to 10% of its credit sales. The tax base of Alter’s accounts receivable at the end of 20X8 is *closest* to:

84) \_\_\_\_\_\_

A) $35,000.   
 B) $31,500.  
 C) $3,500.

**85)** A bond is issued at the end of the year 20X0 with an 8% semiannual coupon rate, 5 years to maturity, and a par value of $1,000. The bond's yield at issuance is 10%. Using the effective interest method, if the yield has decreased to 9% at the end of the year 20X1, the balance sheet liability for the bond is *closest to*:

85) \_\_\_\_\_\_

A) $967.   
 B) $935.  
 C) $923.

**86)** A company purchases a new pizza oven for $12,675. It will work for 5 years and have no salvage value. The company will depreciate the oven over 5 years using the straight-line method for financial reporting, and over 3 years for tax reporting. If the tax rate for years 4 and 5 changes from 41% to 31%, the deferred tax liability as of the end of year 3 is *closest* to:

86) \_\_\_\_\_\_

A) $1,040.   
 B) $2,080.  
 C) $1,570.

**87)** The effect of an inventory writedown on a firm’s return on assets (ROA) is *most accurately* described as:

87) \_\_\_\_\_\_

A) higher ROA in the current period and lower ROA in later periods.   
 B) lower ROA in the current period and higher ROA in later periods.  
 C) lower ROA in the current period and no effect on ROA in later periods.

**88)** Selected information from Jenner, Incorporated’s financial statements for the year ended December 31 included the following (in $):

|  |  |  |  |
| --- | --- | --- | --- |
| **Cash** | $ 200,000 | **Accounts Payable** | $ 300,000 |
| **Accounts Receivable** | 300,000 | **Deferred Tax Liability** | 600,000 |
| **Inventory** | 1,500,000 | **Long-term Debt** | 8,100,000 |
| **Property, Plant & Equipment** | 11,000,000 | **Common Stock** | 2,200,000 |
| **Total Assets** | 13,000,000 | **Retained Earnings** | 1,800,000 |
|  |  | **Total Liabilities & Equity** | $ 13,000,000 |
| **LIFO Reserve at January 1** | 400,000 |  |  |
| **LIFO Reserve at December 31** | 600,000 |  |  |
| **Net Income (after 40% tax rate)** | 800,000 |  |  |

Jenner uses the last in, first out (LIFO) inventory cost flow assumption. If Jenner had used first in, first out (FIFO), return on total equity would:

88) \_\_\_\_\_\_

A) increase to 21.1%.   
 B) decrease to 18.3%.  
 C) increase to 23.0%.

**89)** Selected financial data from Krandall, Incorporated’s balance sheet for the year ended December 31 was as follows (in $):

|  |  |  |  |
| --- | --- | --- | --- |
| **Cash** | $ 1,100,000 | **Accounts Payable** | $ 400,000 |
| **Accounts Receivable** | 300,000 | **Deferred Tax Liability** | 700,000 |
| **Inventory** | 2,400,000 | **Long-term Debt** | 8,200,000 |
| **Property, Plant & Equipment** | 8,000,000 | **Common Stock** | 1,000,000 |
| **Total Assets** | 11,800,000 | **Retained Earnings** | 1,500,000 |
|  |  | **Total Liabilities & Equity** | 11,800,000 |
| **LIFO Reserve at January 1** | 600,000 |  |  |
| **LIFO Reserve at December 31** | 900,000 |  |  |

Krandall uses the last in, first out (LIFO) inventory cost flow assumption. The tax rate is 40%. If Krandall used first in, first out (FIFO) instead of LIFO and paid any additional tax due, its assets-to-equity ratio would be *closest* to:

89) \_\_\_\_\_\_

A) 3.73   
 B) 4.06  
 C) 4.18

**90)** A health care company purchased a new MRI machine on 1/1/X3. At year-end the company recorded straight-line depreciation expense of $75,000 for book purposes and accelerated depreciation expense of $94,000 for tax purposes. Management estimates warranty expense related to corrective eye surgeries performed in 20X3 to be $250,000. Actual warranty expenses of $100,000 were incurred in 20X3 related to surgeries performed in 20X2. The company’s tax rate for the current year was 35%, but a tax rate of 37% has been enacted into law and will apply in future periods. Assuming these are the only relevant entries for deferred taxes, the company’s recorded changes in deferred tax assets and liabilities on 12/31/X3 are *closest to*:

|  |  |  |
| --- | --- | --- |
|  | **DTA** | **DTL** |
| **A)** | $52,500 | $6,650 |
| **B)** | $55,500 | $6,650 |
| **C)** | $55,500 | $7,030 |

90) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**91)** U.S. GAAP *least likely* requires property, plant, and equipment to be tested for impairment:

91) \_\_\_\_\_\_

A) when events indicate the firm may not recover the asset’s carrying value.   
 B) when an asset is reclassified as held-for-sale.  
 C) at least annually.

**92)** Moore Limited uses the LIFO inventory cost flow assumption. Its cost of goods sold in 20X8 was $800. A footnote in its financial statements reads: “Using FIFO, inventories would have been $70 higher in 20X8 and $80 higher in 20X7.” Moore’s COGS if FIFO inventory costing were used in 20X8 is *closest* to:

92) \_\_\_\_\_\_

A) $730.   
 B) $790.  
 C) $810.

**93)** Using the lower of cost or market principle under U.S. GAAP, if the market value of inventory falls below its historical cost, the minimum value at which the inventory can be reported in the financial statements is the:

93) \_\_\_\_\_\_

A) net realizable value minus selling costs.   
 B) market price minus selling costs minus normal profit margin.  
 C) net realizable value.

**94)** Enduring Corporation operates in a country where net income from sales of goods are taxed at 40%, net gains from sales of investments are taxed at 20%, and net gains from sales of used equipment are exempt from tax. Installment sale revenues are taxed upon receipt.  
   
 For the year ended December 31, 2004, Enduring recorded the following before taxes were considered:  
 ● Net income from the sale of goods was $2,000,000, half was received in 2004 and half will be received in 2005.  
 ● Net gains from the sale of investments were $4,000,000, of which 25% was received in 2004 and the balance will be received in the 3 following years.  
 ● Net gains from the sale of equipment were $1,000,000, of which 50% was received in 2004 and 50% in 2005.  
   
 On its financial statements for the year ended December 31, 2004, Enduring should apply an effective tax rate of:

94) \_\_\_\_\_\_

A) 26.67% and increase its deferred tax liability by $1,000,000.   
 B) 22.86% and increase its deferred tax liability by $1,000,000.  
 C) 22.86% and increase its deferred tax asset by $1,000,000.

**95)** Capitalizing interest costs related to a company’s construction of assets for its own use is *required* by:

95) \_\_\_\_\_\_

A) U.S. GAAP only.   
 B) IFRS only.  
 C) both IFRS and U.S. GAAP.

**96)** A U.S. company uses the LIFO method to value its inventory for their income tax return. For its financial statements prepared for shareholders, the company may:

96) \_\_\_\_\_\_

A) use the FIFO method, but must disclose a LIFO reserve.   
 B) only use the LIFO method.  
 C) use any other inventory method under generally accepted accounting principles (GAAP).

**97)** Novak, Incorporated owns equipment with a historical cost of $20,000, a useful life of 5 years, and an estimated salvage value of $5,000. Using the double declining balance method, depreciation expense in Year 3 for this equipment is:

97) \_\_\_\_\_\_

A) $3,000.00   
 B) $2,200.00  
 C) $2,880.00

**98)** A company redeems $10,000,000 of bonds that it issued at par value for 101% of par or $10,100,000. In its statement of cash flows, the company will report this transaction as a:

98) \_\_\_\_\_\_

A) $10,100,000 CFO outflow.   
 B) 10,100,000 CFF outflow.  
 C) $10,000,000 CFF outflow and $100,000 CFO outflow.

**99)** For a lessor that reports under U.S. GAAP, a lease is classified as an operating lease if:

99) \_\_\_\_\_\_

A) ownership risks are not substantially transferred to the lessee.   
 B) the fair value of the asset is greater than the sum of the lease payments and the asset’s expected residual value.  
 C) it cannot be classified as a sales-type lease or a direct financing lease.

**100)** A firm has deferred tax assets of $315,000 and deferred tax liabilities of $190,000. If the tax rate increases, adjusting the value of the firm's deferred tax items will:

100) \_\_\_\_\_\_

A) have no effect on income tax expense.   
 B) decrease income tax expense.  
 C) increase income tax expense.

**101)** For a firm financed with common stock and long-term fixed-rate debt, an analyst should *most appropriately* adjust which of the following items for a change in market interest rates?

101) \_\_\_\_\_\_

A) Cash flow from financing.   
 B) Interest paid.  
 C) Debt-to-equity ratio.

**102)** On December 31, 20X3 Okay Company issued 10,000 $1000 face value 10-year, 9% bonds to yield 7%. The bonds pay interest semi-annually. On its financial statements (prepared under U.S. GAAP) for the year ended December 31, 20X4, the effect of this bond on Okay's cash flow from operations is:

102) \_\_\_\_\_\_

A) −$755,735.   
 B) −$900,000.  
 C) −$700,000.

**103)** A U.S. GAAP firm writes down inventory to net realizable value. In the period of the writedown, what is the *most likely* effect on cost of goods sold?

103) \_\_\_\_\_\_

A) No effect.   
 B) Increase.  
 C) Decrease.

**104)**

|  |  |  |
| --- | --- | --- |
| A company issues an annual-pay bond with the following characteristics: | | |
| **Face value** | $ 67,831 |  |
| **Maturity** | 4 | years |
| **Coupon** | 7% |  |
| **Market interest rates** | 8% |  |

What is the unamortized discount at the end of the first year?

104) \_\_\_\_\_\_

A) $1,209.   
 B) $1,750.  
 C) $499.

**105)** Deferred tax items should be measured based on the:

105) \_\_\_\_\_\_

A) tax rate that will apply when the temporary difference reverses.   
 B) firm’s effective tax rate at the time when the temporary difference reverses.  
 C) statutory tax rate at the time when the temporary difference is recognized.

**106)** A company acquires an intangible asset for $100,000 and expects it to have a value of $20,000 at the end of its 5-year useful life. If the company amortizes the asset using the double-declining balance method, amortization expense in year 4 of the asset’s useful life is *closest* to:

106) \_\_\_\_\_\_

A) $8,640.   
 B) $6,910.  
 C) $1,600.

**107)** In analyzing disclosures related to the financing liabilities of a company, which of the following disclosures would be *least* helpful to the analyst?

107) \_\_\_\_\_\_

A) The present value of the future bond payments discounted at the coupon rate of the bonds.   
 B) The interest expense for the period as provided on the income statement or in a footnote.  
 C) Filings with the Securities and Exchange Commission (SEC) that disclose all outstanding securities and their features.

**108)** Dubois Company bought land for company use five years ago for €2 million and presents its balance sheet value as €2.2 million. If the fair value of the land decreases to €1.8 million, Dubois will:

108) \_\_\_\_\_\_

A) decrease shareholders’ equity by €400,000 but will not recognize a loss.   
 B) recognize a loss of €400,000 and decrease shareholders’ equity by €200,000.  
 C) recognize a loss of €200,000 and decrease shareholders’ equity by €400,000.

**109)** Under IFRS, deferred tax assets and deferred tax liabilities are classified on the balance sheet as:

109) \_\_\_\_\_\_

A) either current or noncurrent items.   
 B) noncurrent items.  
 C) current items.

**110)** Deferred taxes must be recognized for undistributed earnings from an investment in an associate firm under:

110) \_\_\_\_\_\_

A) neither IFRS nor U.S. GAAP.   
 B) U.S. GAAP only.  
 C) both IFRS and U.S. GAAP.

**111)** Fred Company has a deferred tax liability of $1,200,000. If Fred’s tax rate increases from 30% to 40%, the impact of this tax rate change will:

111) \_\_\_\_\_\_

A) increase Fred’s income tax expense by $400,000.   
 B) decrease Fred’s income tax expense by $120,000.  
 C) increase Fred’s income tax expense by $120,000.

**112)** Robbins, Incorporated, reports under IFRS and uses the effective interest rate method for valuing its bond liabilities. Robbins sells a 10-year, $100 million, 5% annual coupon bond issue for $98 million and paid $500,000 in issuance costs. Two years later, the bond liability Robbins will report on its balance sheet for this debt is *closest* to:

112) \_\_\_\_\_\_

A) $98.1 million.   
 B) $98.0 million.  
 C) $97.9 million.

**113)** Which of the following is *least likely* required for a lease to be classified as a direct financing lease by the lessor under U.S. GAAP?

113) \_\_\_\_\_\_

A) The lease transfers substantially all the benefits and risks of ownership to the lessee.   
 B) The sum of the lease payments and asset’s residual value is not less than the asset value.  
 C) A third party guarantees the payment of the residual value of the lease to the lessor.

**114)** Cody Scott would like to screen potential equity investments to identify value stocks and selects firms that have low price-to-sales ratios. Unfortunately, screening stocks based only on this criterion may result in stocks that have poor profitability or high financial leverage, which are undesirable to Scott. Which of the following filters could be added to the stock screen to *best* control for poor profitability and high financial leverage?  
   
 Filter #1 – Include only stocks with a debt-to-equity ratio that is above a certain benchmark value.  
   
 Filter #2 – Include only dividend paying stocks.  
   
 Filter #3 – Include only stocks with an assets-to-equity ratio that is below a certain benchmark value.  
   
 Filter #4 – Include only stocks with a positive return-on-equity.

|  |  |  |
| --- | --- | --- |
|  | **Poor profitability** | **High financial leverage** |
| **A)** | Filter #2 | Filter #3 |
| **B)** | Filter #4 | Filter #3 |
| **C)** | Filter #4 | Filter #1 |

114) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**115)** Mechanisms that enforce discipline over financial reporting quality *least likely* include:

115) \_\_\_\_\_\_

A) government securities regulators.   
 B) counterparties to private contracts.  
 C) accounting standard-setting bodies.

**116)** Portsmouth Industries has stated that in the market for their medical imaging product, their strategy is to grow their market share in the premium segment by leveraging their research and development capabilities to produce machines with greater resolution for the most challenging cases of spinal degeneration. An analyst examining their financials for subsequent periods would *most likely* conclude that they are successfully pursuing this strategy if she finds:

116) \_\_\_\_\_\_

A) increasing research and development expense and decreasing operating margins.   
 B) an increase in revenue and operating margins.  
 C) an increase in gross margins greater than the increase in operating margins.

**117)** A significant increase in days payables above historical levels is *most likely* associated with:

117) \_\_\_\_\_\_

A) an unsustainable increase in reported earnings.   
 B) an increase in net working capital.  
 C) low quality of the cash flow statement.

**118)** Baetica Company reported the following selected financial statement data for the year ended December 31, 20X7:

|  |  |  |
| --- | --- | --- |
|  | **in millions** | **% of Sales** |
| **For the year ended December 31, 20X7:** |  |  |
| **Sales** | $ 500 | 100% |
| **Cost of goods sold** | (300) | 60% |
| **Selling and administration expenses** | (125) | 25% |
| **Depreciation** | (50) | 10% |
| **Net income** | $ 25 | 5% |
| **As of December 31, 20X7:** |  |  |
| **Non-cash operating working capitala** | $ 100 | 20% |
| **Cash balance** | $ 35 | N/A |

aNon-cash operating working capital = Receivables + Inventory − Payables   
   
 Baetica expects that sales will increase 20% in 20X8. In addition, Baetica expects to make fixed capital expenditures of $75 million in 20X8. Ignoring taxes, calculate Baetica’s expected cash balance, as of December 31, 2008, assuming all of the common-size percentages remain constant.

118) \_\_\_\_\_\_

A) $80 million.   
 B) $30 million.  
 C) $40 million.

**119)** An analyst has decided to identify value stocks for investment by screening for companies with high book-to-market ratios and high dividend yields. A potential drawback of using these screens to find value stocks is that the firms selected may:

119) \_\_\_\_\_\_

A) be those that have significantly underperformed the market.   
 B) be concentrated in specific industries.  
 C) have unsustainable dividend payments.

**120)** National Scooter Company and Continental Chopper Company are motorcycle manufacturing companies. National’s target market includes consumers that are switching to motorcycles because of the high cost of operating automobiles and they compete on price with other manufacturers. The average age of National’s customers is 24 years.  
   
 Continental manufactures premium motorcycles and aftermarket accessories and competes on the basis of quality and innovative design. Continental is in the third year of a five-year project to develop a customized hybrid motorcycle. Which of the two firms would most likely report higher gross profit margin, and which firm would most likely report higher operating expense stated as a percentage of total cost?

|  |  |  |
| --- | --- | --- |
|  | **Higher gross profit margin** | **Higher percentage operating expense** |
| **A)** | National | Continental |
| **B)** | Continental | National |
| **C)** | Continental | Continental |

120) \_\_\_\_\_\_

A) Option A   
 B) Option B  
 C) Option C

**121)** The *most likely* problem with using financial statement ratios to screen for stocks to include in a portfolio is that:

121) \_\_\_\_\_\_

A) specific industries are often over-represented.   
 B) firm characteristics are not identified well by financial statement measures.  
 C) firms with undesirable characteristics will be included.

**Answer Key**Test name: Financial Reporting and Analysis

1) C

International Accounting Standard (IAS) No. 1 defines which financial statements are required and how they must be presented. The required financial statements are: ● Balance sheet.  
 ● Statement of comprehensive income.  
 ● Cash flow statement.  
 ● Statement of changes in equity.  
 ● Explanatory notes, including a summary of accounting policies.  
   
 Disclosures of material events that affect the company are required by the Securities and Exchange Commission (Form 8-K) for firms that are publicly traded in the United States.

2) C

IFRS recommends that management commentary address the company’s key relationships, resources, and risks, as well as the nature of the business, management’s objectives, the company’s past performance, and the performance measures used. Securities regulators may impose requirements for publicly traded firms to address certain topics in management’s commentary, but accounting standards do not.

3) B

Able’s basic earnings per share ((Net Income − Preferred Stock Dividends) / weighted average shares outstanding) for 2004 was [($720,000 − ($500 × 6,000 × 0.03) − ($1,000 × 1,000 × 0.08)] / 1,000,000 =$0.55. If the convertible preferred were converted to common stock on January 1, 6,000 × 40 = 240,000 additional shares would have been issued. Also, dividends on the convertible preferred would not have been paid.   
   
 So diluted EPS was ($720,000 − 80,000) / (1,000,000 + 240,000) = $0.52.

4) A

1,000,000(12) = 12,000,000   
   
 100,000(12) = 1,200,000   
   
 400,000(3) = 1,200,000   
   
 Total = 14,400,000 / 12 = 1,200,000

5) A

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 3 / 2 = 1.5 (new current ratio) and (3 − 2.2) / 2 = 0.4 (new quick ratio).

6) A

formula1.mml

7) B

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

8) A

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

9) B

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

10) B

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

11) B

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

12) B

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.

13) A

Common-size balance sheets express each balance sheet item as a percentage of total assets. Contributed capital from issuing common shares may be included in common stock (at par value) or additional paid-in capital (for proceeds in excess of par value). Shareholders’ equity is unlikely to consist only of common and preferred stock, as it also includes components such as retained earnings and accumulated other comprehensive income.

14) C

Orange’s basic EPS ((net income − preferred dividends) / weighted average common shares outstanding) is [($7,600,000 − (10,000 × $1,000 × 0.08)] / 2,000,000 = $3.40. To check for dilution, EPS is calculated under the assumption that the convertible preferred shares are converted into common shares at the beginning of the year. The preferred dividends paid are added back to the numerator of the Diluted EPS equation, and the additional common shares are added to the denominator of the equation. Orange’s if-converted EPS is $7,600,000 / (2,000,000 + 200,000) = $3.45. Because if- converted EPS is higher than basic EPS, the preferred stock is antidilutive and no adjustment is made to basic EPS.

15) C

Beginning with net sales, calculating cash collected from customers requires the addition (subtraction) of any increase (decrease) in unearned revenue. Cash advances from customers represent unearned revenue and are not included in net sales, so any advances must be added to net sales in order to calculate cash collected.   
   
 An inventory writedown, as a result of applying the lower of cost or market rule, will reduce ending inventory and increase COGS for the period. However, no cash flow is associated with the writedown, so COGS is reduced by the amount of the writedown in calculating cash paid to suppliers.

16) B

Investing Activities:  
   
 $10,000 − $180,000 = −$170,000 cash flow from investing or $170,000 used  
 Financing Activities:  
   
 $38,000 − $75,000 = −$37,000 cash flow from financing or $37,000 used  
   
 Note that the question asked for net cash used therefore this is a positive cash outflow.

17) C

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

18) B

Number of average common shares:   
   
 1/1 5,500 shares issued (includes 10% stock dividend on 6/1) × 12 = 66,000 7/1 1,000 shares repurchased × 6 months = −6,000 = 60,000   
   
 60,000 shares / 12 months = 5,000 average shares   
   
 Preferred dividends = ($10) (1,000) = $10,000   
   
 Number of shares from the conversion of the preferred shares = (1,000 preferred shares) (8 × 1.1 shares of common/share of preferred) = 8,800 common   
   
 Diluted EPS = [$15,000(NI) − $10,000(pfd) + $10,000(pfd)] / (5,000 common shares + 8,800 shares from the convertible preferred) = $15,000 / 13,800 shares = $1.09/share   
   
 This number needs to be compared to basic EPS to see if the preferred shares are antidilutive.   
   
 Basic EPS = [$15,000(NI) − $10,000(preferred dividends)] / 5,000 shares = $5,000 / 5,000 shares = $1/share   
   
 Since the EPS after the conversion of the preferred shares is greater than before the conversion the preferred shares are antidilutive and they should not be treated as common in computing diluted EPS. Therefore diluted EPS is the same as basic EPS or $1/share.

19) A

Liabilities are equal to $3,790 million ($240 million unearned revenue + $1,570 long-term debt + $1,150 accounts payable + $830 accrued expenses). Stockholders’ equity is equal to $3,420 million ($30 common stock at par + $440 capital in excess of par − $2,000 treasury stock + $5,160 retained earnings − $210 accumulated other comprehensive loss).

20) B

On a common size income statement, all amounts are stated as a percentage of sales. Interest expense per dollar of sales has declined from 0.15 to 0.06. The other interpretations listed are not necessarily correct. COGS increased as a percentage of sales, but if sales decreased, COGS may have decreased as well. The company's effective tax rate (income tax expense / pretax income) can be calculated from a common-size income statement. Here the effective tax rate was 33% in both years.

21) A

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

22) C

Operating cash flow is equal to $36.1 million ($43.7 million net income + $4.2 million depreciation expense − $8 million gain on sale − $1.5 million increase in receivables − $2.3 million decrease in payables). Net capital expenditures are equal to $20 million ($35 million equipment purchased − $15 million proceeds from sale). Free cash flow to the firm is equal to $16.1 million ($36.1 million operating cash flow − $20 million net capital expenditures).

23) A

Equipment is reported in the balance sheet at historical cost less accumulated depreciation.

24) B

CFO = sales $3,000,000 − change in accounts receivable ($200,000 − $300,000) − purchases $1,800,000 − other cash operating expenses $400,000 = $900,000.   
 Note that no adjustment for inventories is necessary because purchases are given. From the inventory equation, P = COGS + EI − BI.

25) C

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

26) C

Comprehensive income includes all transactions that affect shareholders’ equity except transactions with shareholders. Thus, any transaction that affects net income would also affect comprehensive income. Since the inventory write-down is included in net income, it is part of comprehensive income. The acquisition of treasury stock is a transaction with shareholders; thus, it is not a part of comprehensive income.

27) A

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

28) B

Both items are included in comprehensive income. Comprehensive income includes all items that affect owners’ equity except transactions with the company’s owners. Any items that are included in net income are also included in comprehensive income. The gain on sale is reported in net income. The foreign currency translation loss is taken directly to owners’ equity (i.e., not reported in the income statement).

29) A

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

30) C

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).

31) A

Only the options and convertible preferred stock are dilutive. First, calculate basic EPS to use as a benchmark to determine dilutive capital components.   
   
 Basic EPS = (net income − preferred dividends) / weighted average common shares outstanding = (9.0 − 1.5) / 5.0 = $1.50.   
   
 Next, check for dilution. ● The stock options are dilutive because the exercise price is less than the average stock price. There is no numerator impact from the options. The denominator impact = # options − [(# options × exercise price) / average stock price)] = 400,000 − [(400,000 × 32) / 35] = 34,286 or 0.034 million.  
 ● To check whether the convertible preferred stock is dilutive we need to determine whether it decreases EPS. To the numerator, we add back the preferred dividend. The denominator impact = (# preferred shares × conversion rate) = 500,000 × 5 = 2,500,000, or 2.5 million. Then, EPS = (9.0 − 1.5 + 1.5) / (5.0 + 2.5) = $1.20. Thus the convertible preferred stock is dilutive.  
 ● To check whether the convertible bonds are dilutive we need to determine whether they decrease EPS. To the numerator, we add back the after-tax impact of the coupon, or (face value × coupon × (1 − t)), or (10,000 bonds × 1,000 par × 0.06 coupon × 0.6 ) = 360,000, or $0.360 million. The denominator impact = (# convertible bonds × conversion rate) = 10,000 × 8 = 80,000, or 0.080 million. Then, EPS = (9.0 − 1.5 + 0.360) / (5.0 + 0.080) = $1.55. Thus the bonds are antidilutive.  
 Finally, calculate diluted EPS:   
   
 Diluted EPS = (9.0 − 1.5 + 1.5) / (5.0 + 2.5 + 0.034) = $1.1946.

32) C

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

33) C

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

34) B

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

35) B

The recognition of bad debt expense has no effect on liabilities, current revenues are reduced by the expected amount of uncollectable accounts. Bad debt expense reduces net income and reduces assets. The recognition of expected warranty expense decreases net income (following the matching principle), and since it is not currently paid (doesn’t reduce assets) it creates or increases a liability at the time of sale.

36) C

The interest expense for three months net of tax is added to the numerator (12% × $100,000 × 3/12 × 60 %) = $1,800. The number of shares added to the denominator are 4,500. (18,000 × 3 / 12).

37) B

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

38) B

Restructuring and plant shutdown costs are considered part of a company’s normal operations. Gains and losses related to discontinued operations are reported separately in the income statement because these activities are no longer included as part of the company’s continuing operations.

39) B

Since Red Oak is a nonfinancial firm, the accrued interest is considered a nonoperating activity, related to how the firm is financed. Dividends paid to preferred shareholders do not affect net income.

40) A

Feder’s basic earnings per share ((net income − preferred dividends) / weighted average shares outstanding) was (($7,650,000 − ($1,000 × 10,000 × 0.06)) / 1,100,000 =) $6.41.   
   
 If the convertible preferred stock was converted to common stock at January 1, (10,000 × 20 =) 200,000 additional common shares would have been issued, dividends on the preferred stock would not have been paid, and Diluted EPS would have been ($7,650,000 / (1,100,000 + 200,000) = $5.88. Because $5.88 is less than basic EPS of $6.41, the preferred shares are dilutive.   
   
 Using the treasury stock method, if the options were exercised cash inflow would be (70,000 × 10 × $50 =) $35,000,000. The number of Feder shares that can be purchased with the inflow (cash inflow divided by the average share price) is ($35,000,000 / $62 =) 564,516.   
   
 The number of shares that would have been created is (700,000 − 564,516 =) 135,484. Diluted EPS was [($7,650,000 − ($1,000 × 10,000 × 0.06)] / (1,100,000 + 135,484) =) $5.71. Because this is less than the EPS of $6.41, the options are dilutive.   
   
 Combining the calculations, Diluted EPS was (($7,650,000) / (1,100,000 + 200,000 + 135,484) = $5.32. (Study Session 7, Module 21.4, LOS 21.h)

41) B

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

42) A

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.

43) C

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

44) C

Interest received from customers and interest received from investments are a part of normal operations of a financial institution. Thus, the First National Bank will report the interest income from both sources as components of operating income.

45) C

Average stock price is not a factor in determining whether convertible bonds are dilutive or antidilutive.   
   
 If Young redeemed the bonds, they would have no potentially dilutive securities outstanding in 20X5 and diluted EPS, if the company reported it, would equal basic EPS. Basic and diluted EPS would also be equal in 20X5 if the bonds were antidilutive in that year.

46) C

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

47) B

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

48) A

To compute Hampshire’s basic EPS ((net income − preferred dividends) / weighted average common shares outstanding), the weighted average common shares must be computed. 100,000 shares were outstanding from January 1, and 30,000 shares were issued on September 1, so the weighted average is 100,000 + (30,000 × 4 / 12) = 110,000. Basic EPS is ($2,800,000 − (10,000 × $1,000 × 0.06)) / 110,000 = $20.00.   
   
 If the warrants were exercised, cash inflow would be 10,000 × $150 × 10 = $15,000,000 for 10 × 10,000 = 100,000 shares. Using the treasury stock method, the number of Hampshire shares that can be purchased with the cash inflow (cash inflow / average share price) is $15,000,000 / $250 = 60,000. The number of shares that would be created is 100,000 − 60,000 = 40,000. Diluted EPS is $2,200,000 / (110,000 + 40,000) = $14.67.

49) A

To compute Gerrard’s basic earnings per share (EPS) ((net income − preferred dividends) / weighted average common shares outstanding), the weighted average common shares outstanding must be computed. 700,000 shares were outstanding from January 1, and 200,000 shares were issued on March 1, so the weighted average is 700,000 + (200,000 × 10 / 12) = 866,667. Basic EPS was $330,000 − (2,000 × $500 × 0.08)) / 866,667 = $0.289.   
   
 If the convertible preferred shares were converted to common stock, 2,000 × 200 = 400,000 additional common shares would have been issued and dividends on the preferred stock would not have been paid. Diluted EPS was $330,000 / (866,667 + 400,000) = $0.261.

50) C

A firm with any potentially dilutive securities outstanding must report both basic and diluted EPS, even if the two are equal. If convertible preferred stock is dilutive to earnings per share, the preferred dividend is added back to the numerator as if the preferred has been converted to common shares. If diluted EPS is less than basic EPS then the convertible preferred is said to be dilutive.

51) B

Unrealized foreign currency translation gains and losses are not reported in the income statement; thus, retained earnings are unaffected. However, unrealized foreign currency gains and losses are included in comprehensive income. Comprehensive income includes all changes in equity except those that result from transactions with shareholders. So, the translation gain increases stockholders’ equity by increasing comprehensive income.

52) A

During the first year, the revenue was 700,000 / 1,300,000 × 2,000,000 =  
 1,076,923 The total revenue for both years = $2,000,000  
   
 The second year revenue was 2,000,000 − 1,076,923 = $923,077  
   
 The second year income = revenues − costs = 923,077 − 1,000,000 = $−76,923

53) A

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

54) C

Inventory costs are expensed when items are sold under the matching principle. As an extreme example, if no sales are made, no costs of inventory production are expensed for the period. Period costs are expensed during the period. Under the accrual method, interest accrued during the period is expensed, regardless of whether it has been paid during the period.

55) C

Using the indirect method, CFO = Net income 25 + increase in accounts payable 20 + increase in deferred taxes 5 − profit on sale of equipment 15 = $35.   
   
 Increases in accounts payable and deferred taxes are sources of operating cash that are not included in net income and must be added. Profit on sale of equipment is a CFI item that must be removed from net income.   
   
 No adjustment needs to be made for cash payment of dividends (CFF), sale of preferred stock (CFF), or purchase of land (CFI) because they are not included in net income. Only the profit on sale of equipment, not the full proceeds from sale, is included in net income.

56) B

Under U.S. GAAP, interest received is reported as an operating cash flow. For a non-financial services company, interest received is typically reported as non-operating income.

57) C

Inventory costs are expensed when items are sold under the matching principle. As an extreme example, if no sales are made, no costs of inventory production are expensed for the period. Period costs are expensed during the period. Under the accrual method, interest accrued during the period is expensed, regardless of whether it has been paid during the period.

58) A

The trading securities classification includes the unrealized gain from the bond in net income, which increases retained earnings. Unrealized gains on available-for-sale securities are reported as other comprehensive income for the period and are recorded in accumulated other comprehensive income, a component of owner's equity. Unrealized gains on held-to-maturity securities are not reported on the financial statements.

59) C

The analyst believes an expenditure the firm classified as an investing cash outflow should have been classified as an operating cash outflow. Thus, the analyst should adjust CFO downward and CFI upward.

60) B

Common-size cash flow statements show each cash flow item as a percentage of revenue or show each cash flow outflow as a percentage of all cash outflows and each cash inflow as a percentage of all cash inflows.

61) C

Unrealized gains and losses from trading securities are reflected in the income statement and affect owners' equity. However, unrealized gains and losses from available-for-sale securities are included in other comprehensive income. Transactions included in other comprehensive income affect equity but not net income. Dividends paid to shareholders reduce owners' equity but not net income.

62) B

For long-lived assets classified as investment property, IFRS allows either the cost model or the fair value model. The revaluation model is permitted for long-lived assets that are not classified as investment property. U.S. GAAP only permits the cost model for valuation of long-lived assets and does not identify investment property as a specific subset of long-lived assets.

63) C

If Train decided to amortize the cost, the franchise would be capitalized as a balance sheet asset and the cash outflow would have been classified as CFI. As a result CFO would have been $8 million higher, or $14 million + $8 million = $22 million. Amortization would be a non-cash expense.

64) C

According to IFRS, property held for the purpose of earning rental income is classified as investment property. However, when a property is transferred from owner-occupied to investment property, a firm using the fair value model must treat any increase in the property's value as a revaluation. That is, the firm may only recognize a gain on the income statement to the extent that it reverses a previously recognized loss.

65) B

Under the fair value model, all gains and losses from changes in the value of investment property are recognized on the income statement. The firm will recognize a loss of €150,000 in Year 1 and a gain of €200,000 in Year 2.

66) A

Undistributed profits from a subsidiary do not require the creation of a deferred tax liability under U.S. GAAP if the subsidiary meets the indefinite reversal criterion. For IFRS, there are circumstances where a DTL is not created but the test for this treatment is not called or equivalent to the indefinite reversal criterion detailed in U.S. GAAP.

67) C

Assuming normal capacity levels, allocation of fixed production overhead is a product cost that is capitalized as part of inventory. Thus, this cost will not be recognized as an expense until the inventory is sold (it becomes part of COGS for that period). Administrative overhead and selling costs are period costs that must be expensed in the period incurred.

68) C

The $200,000 difference between the tax base and the carrying value of the equipment gives rise to a deductible temporary difference that leads to a deferred tax asset (DTA) of $80,000 ($200,000 × 40%). The tax loss carryforward of $300,000 also leads to a DTA but for $120,000 ($300,000 × 40%).   
   
 The decrease in the tax rate from 40% to 35% will reduce the DTA of the equipment by $10,000 ($200,000 × 5%). It will reduce the DTA of the tax loss carryforward by $15,000 ($300,000 × 5%). In total, the DTA will decrease by $25,000. The decrease in the value of the DTA will increase income tax expense by $25,000 in the period when the DTA is decreased.

69) B

Under IFRS, a tax rate that has been enacted or substantively enacted is used to measure deferred tax items. Under U.S. GAAP, only a tax rate that has actually been enacted can be used.

70) B

Based on a semiannual interest rate of 6.65% (13.30% / 2):

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Period** | **Interest Expense** | **Coupon Payment** | **Discount Amortization** | **Bond Carrying Value** |
| **0** | 0.00 |  |  | $ 800.00 |
| **1** | 53.20 | 25.00 | 28.20 | 828.20 |
| **2** | 55.08 | 25.00 | 30.08 | 858.28 |
| **3** | 57.08 | 25.00 | 32.08 | 890.36 |
| **4** | 59.21 | 25.00 | 34.21 | $ 924.57 |

Interest expense for Year 2 is $57.08 + $59.21 = $116.29.

71) C

When exchanging one long-lived asset for another, a gain or loss is recorded as the difference between the old asset's carrying value and its fair value (or the fair value of the asset received in exchange, if that value is more evident). When selling an asset, the gain or loss is the difference between the carrying value and the cash received. When abandoning an asset, a firm records a loss equal to the carrying value of the asset.

72) C

Neither metric is directly relevant in evaluating the stability of a firm's inventory levels. Determining stability would presumably require other information such as purchase and sales levels, for example. The inventory turnover ratio and the number of days in inventory can be used to evaluate the relative age of a firm's inventory as well as the effectiveness of a firm's inventory management.

73) C

Deferred tax items are classified as noncurrent.

74) A

Estimated amortization expense for the next five years is required by U.S. GAAP but is not required by IFRS.

75) C

Permanent tax differences such as tax credits, non-deductible expenses, and tax differences between capital gains and operating income give rise to differences in the effective and statutory tax rates.

76) A

As bond premium is amortized, interest expense will be successively lower each period, thus increasing earnings over the life of the bond.

77) B

Under U.S. GAAP, the full amount of a DTA is shown on the balance sheet, with a contra account (valuation allowance) if it is likely that the full amount of the DTA will not be realized in the future. Under IFRS, the reported value of a DTA is reduced if there is a positive probability that the full amount of the DTA will not be realized in the future.

78) C

Under U.S. GAAP, a LIFO firm values inventory at the lower of cost or market. Market is equal to the replacement cost subject to replacement cost being within a specific range. The upper bound is net realizable value (NRV), which is equal to selling price ($80) less selling costs ($2) for an NRV of $78. The lower bound is NRV ($78) less normal profit (5% of selling price = $4) for a net amount of $74. Since replacement cost ($73) is less than NRV minus normal profit ($74), then market equals NRV minus normal profit ($74). As well, we have to use the lower of cost ($90) or market ($74) principle so the recorders should be recorded at the lower amount of $74.

79) A

If the franchise cost had been amortized over six years beginning in 20X3, net income in 20X3 would have been $6 million instead of $1 million due to the cost of franchise expense of $6 million being eliminated and replaced by franchise amortization of $1 million. Net income in 20X4 would have been reduced by the franchise amortization to $7 million instead of $8 million. On the equity side, retained earnings at the end of 20X3 would have been $11 million ($5 million higher), and total equity for 20X3 would have been $8 + $11 = $19 million. Retained earnings for 20X4 would be the 20X3 retained earnings of $11 million increased by 20X4 net income of $7 million for a total of $18 million, and total equity for 20X4 would be $8 + $18 = $26 million. If the franchise cost were amortized, return on total equity for 20X4 would be $7 / ((19 + 26) / 2) = 31.1%.

80) C

U.S. GAAP requires the lessee to recognize a balance sheet liability for both finance leases and operating leases.

81) B

The first step is to determine the direction of prices:

|  |  |  |  |
| --- | --- | --- | --- |
| **Purchase** | **Total Cost** | **Units** | **Per-unit Cost** |
| **Begin inventory** | $ 9,500 | ÷ 250 | = $ 38 |
| **3/1/X6** | 14,800 | ÷ 400 | = $ 37 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Purchase** | **Total Cost** | **Units** | **Per-unit Cost** |
| **7/1/X6** | 14,850 | ÷ 450 | = $ 33 |
| **9/1/X6** | 15,950 | ÷ 550 | = $ 29 |

Notice that per-unit prices are falling. Under falling prices, LIFO inventory costing will result in higher net income because the recent units were cheaper than the older purchases (and beginning inventory), making the cost of goods sold lower and net income higher. Working capital will be higher because LIFO inventory is greater than FIFO inventory when prices are falling.

82) C

The required disclosures for long-lived assets under IFRS are more extensive than they are under U.S. GAAP. IFRS requires a reconciliation of beginning and ending carrying values for classes of PP&E, while U.S. GAAP does not.

83) B

When reclassifying a property from owner-occupied to investment property and using the fair value model for valuation of investment property, IFRS specifies that the firm should treat the event as a revaluation, recognizing a gain only if it reverses a previously recognized loss.

84) A

For tax purposes, bad debt expense cannot be deducted until the receivables are deemed worthless. Therefore, the tax base is $35,000 since no bad debt expense has been deducted on the tax return. Note that the carrying value would be $31,500 since bad debt expense is reflected on the income statement.

85) B

Using the effective interest method, the value of the liability is calculated using the bond’s yield at issuance. At the end of 20x1 the bond will have 8 semiannual periods remaining until maturity.   
   
 N = 8; I/Y = 10 / 2 = 5; PMT = 8 / 2 × 1,000 = 40; FV = 1,000; CPT PV = −935.37.

86) C

At the end of year 3, the oven has a tax base of zero (it has been fully depreciated for tax reporting) and a carrying value on the balance sheet of $12,675 − 3(0.2)($12,675) = $5,070. The deferred tax liability, valued at the 31% tax rate that will apply when the temporary difference reverses, is ($5,070 − $0)(0.31) = $1,571.70.

87) B

Writing down inventory to net realizable value decreases both net income and total assets in the period of the writedown. Because net income is most likely less than assets, the result in the period is a decrease in ROA. In later periods, lower-valued inventory will decrease COGS and increase net income. Combined with a lower value of total assets, this will increase ROA.

88) A

Return on total equity (net income / total equity) was $800,000 / ($2,200,000 + $1,800,000) = 20%. Under FIFO, net income increases by the increase in the LIFO reserve multiplied by (1 − tax rate). FIFO net income was $800,000 + ($600,000 − $400,000) (1 − 0.40) = $920,000. Total equity increases by the amount of accumulated FIFO profits that are added to retained earnings, which is calculated by multiplying the amount of the ending LIFO reserve by (1 − tax rate) for an increase of ($600,000) × (1 − 0.40) = $360,000. Total equity is $2,200,000 + $1,800,000 + $360,000 = $4,360,000. FIFO return on total equity is $920,000 / $4,360,000 = 21.1%.

89) B

With FIFO instead of LIFO: ● Inventory would be higher by $900,000, the amount of the ending LIFO reserve.  
 ● Cumulative pretax income would also be higher by $900,000, so taxes paid would be higher by 0.40($900,000) = $360,000. Therefore cash would be lower by $360,000.  
 ● Cumulative retained earnings would be higher by (1 − 0.40)($900,000) = $540,000.  
 So assets under FIFO would be $11,800,000 + $900,000 − $360,000 = $12,340,000 and equity would be $1,000,000 + $1,500,000 + $540,000 = $3,040,000. The assets-to-equity ratio would be $12,340,000 / $3,040,000 = 4.06.

90) C

DTL = (tax depreciation − financial statement depreciation) × future tax rate = ($94,000 − $75,000) × 37% = $7,030.   
 DTA = (estimated warranty expense − actual warranty expense) × future tax rate = ($250,000 − $100,000) × 37% = $55,500.

91) C

Under U.S. GAAP, a PP&E asset is tested for impairment when events and circumstances indicate the firm may not recover its carrying value through future use, or if the asset is reclassified from held-for- use to held-for-sale. Under IFRS, firms are also required to assess at least annually whether events and circumstances indicate impairment may have occurred.

92) C

The ending LIFO reserve is $70 and the beginning LIFO reserve is $80.   
   
 FIFO COGS = LIFO COGS − (ending LIFO reserve − beginning LIFO reserve) $800 − ($70 − $80) = $810

93) B

When inventory is written down to market, the replacement cost of the inventory is its market value, but the “market value” must fall between net realizable value (NRV) and NRV less normal profit margin.   
   
 NRV is the market price of the inventory less selling costs. Therefore the minimum value is the market price minus selling costs minus normal profit margin.

94) B

Total taxes eventually due on 2004 activities were (($2,000,000 × 0.40) + ($4,000,000 × 0.20) =) $1,600,000. Permanent differences are adjusted in the effective tax rate, which is ($1,600,000 / $7,000,000 =) 22.86%. Of the $1,600,000 taxes due, (($2,000,000 × 0.50 × 0.40) + ($4,000,000 × 0.25 × 0.20) =) $600,000 were paid in 2004 and $1,000,000 ($1,600,000 − $600,000) is added to deferred tax liability.

95) C

Both U.S. GAAP and IFRS require companies to capitalize the interest that accrues during the construction of capital assets for their own use.

96) B

The LIFO conformity rule in the U.S. requires firms to use LIFO for their financial statements if they use LIFO for income tax purposes.

97) B

DDB depreciation in each year is 2/5 of the carrying value at the beginning of the year, until the carrying value reaches the estimated salvage value.   
   
 Year 1 DDB depreciation = $20,000 × 2/5 = $8,000 Carrying value = $20,000 − $8,000 = $12,000   
   
 Year 2 DDB depreciation = $12,000 × 2/5 = $4,800 Carrying value = $12,000 − $4,800 = $7,200   
   
 Year 3 DDB depreciation = $7,200 × 2/5 = $2,880   
   
 Because $7,200 − $2,880 = $4,320 would depreciate the equipment below its salvage value, depreciation in Year 3 is limited to $7,200 − $5,000 = $2,200.

98) B

Cash paid to redeem a bond is classified as a cash flow from financing activities.

99) C

Under U.S. GAAP accounting standards for lessors, a lease is classified as an operating lease if it cannot be classified as either a sales-type lease or a direct financing lease. If ownership risks are substantially transferred to the lessee and collection of the payments is reasonably assured, the lessor classifies the lease as a sales-type lease. If ownership risks are not substantially transferred, but a third party guarantees the residual value of the asset and the sum of the lease payments and the residual value is at least equal to the fair value of the asset, the lessor classifies the lease as a direct financing lease.

100) B

An increase in the tax rate increases the values of both DTAs and DTLs. Because the firm's DTAs are greater than its DTLs, the net effect of adjusting their values for an increase in the tax rate will be to decrease income tax expense.

101) C

For the purpose of analysis, the value of debt should be adjusted for a change in interest rates. This will change the debt-to-equity ratio.

102) B

The coupon payment is a cash outflow from operations. ($10,000,000 × 0.09) = $900,000.

103) B

A write-down of inventory to net realizable value is typically recognized under U.S. GAAP as an increase in cost of goods sold in the period of the write-down. Consider the inventory equation:  
 ending inventory = beginning inventory + purchases − cost of goods sold  
   
 A write-down to NRV decreases ending inventory, with no effect on beginning inventory or purchases. For the inventory equation to hold, cost of goods sold must increase.

104) B

Face value of bonds = $67,831   
   
 Proceeds from bond sale: I/Y = 8; N = 4; PMT = $67,831 × 0.07 = $4,748.17; FV = $67,831; CPT PV = $65,582   
   
 Unamortized discount at issuance = $67,831 − $65,582 = $2,249.   
   
 First year interest expense = $65,582 × 0.08 $5,247 Coupon payment = $67,831 × 0.07 = $4,748   
   
 Change in discount = $5,247 − $4,748 = $499   
   
 Unamortized discount at end of first year = $2,249 − $499 = $1,750.

105) A

Measurement of deferred tax items is based on the tax rate that will apply when the temporary difference reverses. In some cases this may depend on how a temporary difference is settled, which determines whether a capital gains tax rate or income tax rate will apply.

106) C

Net book value at the end of year 3 is $100,000 × 3/5 × 3/5 × 3/5 = $21,600. DDB amortization in year 4 of 2/5 × $21,600 = $8,640 would amortize the asset below its salvage value, so amortization expense is the remaining $1,600 that will amortize net book value to $20,000.

107) A

When analyzing disclosures related to financing liabilities, analysts would review the balance sheet and find the present value of the promised future liability payments. These payments would then be discounted at the rate in effect at issuance (i.e., the yield to maturity), not the coupon rate of the bonds.

108) C

Because the land is valued above its historical cost on the balance sheet, Dubois is using the revaluation model. The land’s revaluation up to €2.2 million would have been reflected in shareholders’ equity with a revaluation surplus of €200,000. The decrease in fair value to €1.8 million will reduce the revaluation surplus to zero, and the amount of the writedown below historical cost (€2 million − €1.8 million = €200,000) will be recognized as a loss on Dubois’s income statement. This loss, combined with the removal of the revaluation surplus, will decrease shareholders’ equity by €400,000. Note that the land was purchased for company use and therefore would not be classified as investment property.

109) B

Under IFRS, deferred tax assets and liabilities are classified as noncurrent. Under U.S. GAAP, deferred tax items may be current or noncurrent, depending on how the underlying asset or liability is classified.

110) B

Deferred taxes must be recognized for undistributed earnings from an investment in an associate firm under U.S. GAAP. Under IFRS, no deferred taxes are reported for undistributed earnings if the investor firm controls the sharing of profits and it is probable the temporary difference will not be reversed in the future.

111) A

The change in Fred’s rates causes its deferred tax liability to increase [(40 − 30) / 30] × $1,200,000 = $400,000. This is reported on the income statement as an increase in current income tax expense.

112) C

Under IFRS, bond liabilities are reported under the effective interest method and issuance costs are deducted from the proceeds to determine the initial liability. The yield at issuance is: PV = 97.5 million; FV = −100 million; PMT = −5 million; N = 10; CPT I/Y = 5.33. Change N to 8 and CPT PV after two years as 97.9 million.

113) A

A direct finance lease under U.S. GAAP is a lessor classification for leases that do not meet the transfer of ownership criteria. The other two conditions must be met. If a lease transfers substantially all the benefits and risks of ownership to the lessee, the lessor classifies it as a sales-type lease.

114) A

Firms that have poor profitability are more likely to be non-dividend paying. Selecting only dividend paying stocks can serve as a check on poor profitability. Using positive ROE to control for poor performance can result in bogus results without additional filters. For example, if both the numerator (net income) and the denominator (average equity) are negative, ROE will be positive. The higher the assets-to-equity ratio, the higher the leverage. Selecting only stocks with an assets-to-equity ratio below a certain cut-off point will eliminate stocks with high leverage. Debt-to-equity above a certain point would include firms with higher, not lower, financial leverage.

115) C

Accounting standard-setting bodies issue financial reporting standards but do not enforce compliance with them. Securities regulators and counterparties to private contracts are among the mechanisms that discipline financial reporting quality.

116) C

A shift to premium, rather than commodity-like, products should result in higher gross margins, higher average revenue per unit (selling price per unit), and an increase in gross margins relative to operating margins (because of the increase in R&D and marketing expenditures). A successful shift to a premium product should increase operating margins rather than increase operating income through increased unit sales. Revenue would not necessarily increase as the company shifted to premium products.

117) C

A significant increase in days payables may indicate that payables have been "stretched" (not paid or paid more slowly), which increases operating cash flow in an unsustainable manner and calls the quality of the reported cash flow values into question. Stretching payables does not affect earnings because the related expenses were recognized in the period incurred. An increase in days payables will decrease net working capital, other things equal.

118) B

2008 sales are expected to be $600 million ($500 million 2007 sales × 1.2) and 20X8 net income is expected to be $30 million ($600 million 20X8 sales × 5%). 2008 non-cash operating working capital is expected to be $120 million ($600 million 20X8 sales × 20%). The change in cash is expected to be −$5 million ($30 million 20X8 net income + $60 million 20X8 depreciation − $20 million increase in non- cash operating working capital − $75 million 20X8 capital expenditures). The 20X8 ending balance of cash is expected to be $30 million ($35 million beginning cash balance − $5 million decrease in cash).

119) B

A screen for firms with high dividend yields and high book-to-market ratios would likely result in an inordinate proportion of financial services companies and add a significant element of industry (sector) risk. Uncertainty about sustainability of dividend payments and recent market underperformance are typical characteristics of value stocks in general and not a drawback to using this screen to identify them.

120) C

Continental likely has the highest gross profit margin percentage since it is selling a customized product and does not compete primarily based on price. Because of the research and development costs of developing a new hybrid motorcycle, Continental likely has the higher operating expense stated as a percentage of total cost.

121) A

It is often the case a screening metric, such as low P/E, high dividend yield, or high ROE, will identify many stocks in the same industry. Undesirable characteristics can be avoided by including additional screening metrics. Financial statement measures provide a great amount of information about a firm’s characteristics.