23 INCOME TAXES

1. The cash conversion cycle is the:
   (A) sum of the time it takes to sell inventory and collect on accounts receivable, less the time it takes to pay for credit purchases.
   (B) length of time it takes to sell inventory.
   (C) sum of the time it takes to sell inventory and the time it takes to collect accounts receivable.

2. At the end of 20X8, Martin Inc. estimates that $26,000 of warranty repairs will be required in the future on goods already sold. For tax purposes, warranty expense is not deductible until the work is actually performed. The firm believes that the warranty work will be required over the next two years. The tax base of the warranty liability at the end of 20X8 is:
   (A) $13,000.
   (B) zero.
   (C) $26,000.

3. Selected financial information gathered from the Matador Corporation follows:

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

   Using only the data presented, which of the following statements is most correct?
   (A) Gross profit margin has improved.
   (B) Leverage has declined.
   (C) Return on equity has improved.

4. A company purchased a new pizza oven for $12,676. It will work for 5 years and has no salvage value. The tax rate is 41%, and annual revenues are constant at $7,192. For financial reporting, the straight-line depreciation method is used, but for tax purposes depreciation is 35% of original cost in years 1 and 2 and the remaining 30% in Year 3. For this question ignore all expenses other than depreciation.

   What is the deferred tax liability as of the end of year three?

   (A) $780.

   (B) $2,079.

   (C) $1,029.

5. For purposes of financial analysis, an analyst should:

   (A) always consider deferred tax liabilities as a liability.

   (B) always consider deferred tax liabilities as stockholder's equity.

   (C) determine the treatment of deferred tax liabilities on a case-by-case basis.

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

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

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

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

	Vertical analysis	Horizontal analysis
(A)	Statement #1	Statement#2
(B)	Statement#2	Statement#3
(C)	Statement#2	Statement#1

7. 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:

   (A) both IFRS and U.S. GAAP.

   (B) U.S. GAAP only.

   (C) IFRS only.

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

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

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

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

9. Under IFRS, deferred tax assets and deferred tax liabilities are classified on the balance sheet as:
   (A) noncurrent items.
   (B) either current or noncurrent items.
   (C) current items.

10. 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:
   (A) $2,080.
   (B) $1,040.
   (C) $1,570.

11. Adams Co.'s common sized balance sheet shows that:
   - Current Liabilities = 20%
   - Equity = 45%
   - Current Assets = 45%
   - Total Assets = $2,000

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

Debt to Equity	Working Capital
(A) 0.78	$250
(B) 0.78	$500
(C) 1.22	$500

12. Kruger Associates uses an accrual basis for financial reporting purposes and cash basis for tax purposes. Cash collections from customers are $476,000, and accrued revenue is only $376,000. Assume expenses at 50% in both cases (i.e., $238,000 on cash basis and $188,000 on accrual basis), and a tax rate of 34%. What is the deferred tax asset or liability? A deferred tax:
   (A) liability of $17,000.
   (B) asset of $48,960.
   (C) asset of $17,000.

13. Which of the following ratios would NOT be used to evaluate how efficiently management is utilizing the firm's assets?
   (A) Payables turnover.
   (B) Gross profit margin.
   (C) Fixed asset turnover.

14. Regarding the use of financial ratios in the analysis of a firm's financial statements, it is most accurate to say that:
    (A) variations in accounting treatments have little effect on financial ratios.
    (B) a range of target values for a ratio may be more appropriate than a single target value.
    (C) many financial ratios are useful in isolation.

15. A temporary difference between pretax income reported in a firm's financial statements and taxable income the firm reports to the tax authorities results in:
    (A) a gain or loss in comprehensive income.
    (B) a deferred tax item.
    (C) an adjustment to the firm's effective tax rate.

16. To calculate the cash ratio, the total of cash and marketable securities is divided by:
    (A) total liabilities.
    (B) total assets.
    (C) current liabilities.

17. Which of the following situations will most likely require a company to record a valuation allowance on its balance sheet?
    (A) A firm is unlikely to have future taxable income that would enable it to take advantage of deferred tax assets.
    (B) A firm has differences between taxable and pretax income that are never expected to reverse.
    (C) To report depreciation, a firm uses the double-declining balance method for tax purposes and the straight-line method for financial reporting purposes.

18. Which of the following statements about tax deferrals is NOT correct?
    (A) A deferred tax liability is expected to result in future cash outflow.
    (B) Income tax paid can include payments or refunds for other years.
    (C) Taxes payable are determined by pretax income and the tax rate.

19. Which of the following statements best justifies analyst scrutiny of valuation allowances?
    (A) Changes in valuation allowances can be used to manage reported net income.
    (B) If differences in taxable and pretax incomes are never expected to reverse, a company's equity may be understated.
    (C) Increases in valuation allowances may be a signal that management expects earnings to improve in the future.

20. For the year ended 31 December 2004, Pick Co's pretax financial statement income was $400,000 and its taxable income was $300,000. The difference is due to the following:

Interest on tax-exempt municipal bonds	$140,000
Premium expense on key person life insurance	$(40,000)
Total	$100,000

Pick's statutory income tax rate is 30 percent. In its 2004 income statement, what amount should Pick report as current provision for tax payable?

(A) $90,000.

(B) $102,000.

(C) $120,000.

21. Which of the following best describes valuation allowance? Valuation allowance is a reserve:

(A) against deferred tax liabilities based on the likelihood that those liabilities will be paid.

(B) against deferred tax assets based on the likelihood that those assets will not be realized.

(C) created when deferred tax assets are greater than deferred tax liabilities.

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

Current ratio	2.00
Quick ratio	1.25
Current liabilities	$1,00,000
Inventory turnover	12
Gross profit n%	25

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

(A) $300,000.

(B) $1,200,000.

(C) $900,000.

23. Are the following ratios best classified as profitability ratios?

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

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

(A) Neither of the ratios is a profitability ratio.

(B) Only one of the ratios is a profitability ratio.

(C) Both of the ratios are profitability ratios.

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

	Current ratio	Cash ratio
(A)	Increase	Increase
(B)	No effect	Increase
(C)	No effect	No effect

25. An analyst has gathered the following information about a company:

Balance Sheet	
Asset	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

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

Determine the current ratio and the cash ratio.

	Current Ratio	Cash Ratio
(A)	4.65	0.93
(B)	1.98	1.86
(C)	2.67	1.07

26. An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

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

What is the inventory turnover ratio?

(A) 0.77.
(B) 1.29.
(C) 1.59.

27. An analyst has collected the following data about a firm:
- Receivables turnover = 10 times.
- Inventory turnover = 8 times.
- Payables turnover = 12 times.

The firm's cash conversion cycle is closest to:
(A) 52 days.
(B) 82 days.
(C) 134 days.

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

Income Statement	%
Sales	100.0
Cost of goods sold	58.2
Operating expenses	30.2
Interest expense	0.7
Income tax	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)	2.4	26.8%
(C)	4.6	25.2%

29. 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)	$55,500	$7,030
(B)	$52,500	$6,650
(C)	$55,500	$6,650

30. A company has 1,000,000 warrants outstanding at the beginning of the year, each convertible into one share of stock with an exercise price of $50. No new warrants were issued during the year. The average stock price during the period was $60, and the year-end stock price was $45. What adjustment for these warrants should be made, under the treasury stock method, to the number of shares used to calculate diluted earnings per share (EPS)?
(A) 0.
(B) 166,667.
(C) 200,000.

31. The Puchalski Company reported the following:

	Year 1	Year 2	Year 3	Year 4
Income before taxes	$1,000	$1,000	$900	$800
Taxable income	$800	$900	$900	$1,000

Puchalski has no deferred tax asset or liability prior to Year 1. If the tax rate is 40%, what is the amount of the deferred tax asset or liability reported at the end of Year 3?
(A) Asset of $120.
(B) Asset of $80.
(C) Liability of $120.

32. Deferred tax liabilities may result from:
(A) pretax income greater than taxable income due to permanent differences.
(B) pretax income greater than taxable income due to temporary differences.
(C) pretax income less than taxable income due to temporary differences.

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

Accounts payable turnover	5.0
Cost of goods sold	\$30 million
Average inventory	\$3 million
Average receivables	\$8 million
Total liabilities	\$35 million
Interest expense	\$2 million
Cash conversion cycle	13.5 days

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

(A) \$57.8 million.

(B) \$58.4 million.

(C) \$52.3 million.

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

(A) earnings before income taxes.

(B) gross profit.

(C) operating profit.

35. An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

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

What is the receivables turnover ratio?

(A) 2.0.

(B) 0.5.

(C) 1.0.

36. Deferred taxes must be recognized for undistributed earnings from an investment in an associate firm under:

(A) neither IFRS nor U.S. GAAP.

(B) U.S. GAAP only.

(C) both IFRS and U.S. GAAP.

37. Which of the following financial ratios is least likely to be affected by classification of deferred taxes as a liability or equity?

(A) Leverage ratio.

(B) Return on assets (ROA).

(C) Return on equity (ROE).

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

(A) Neither ratio will decrease.

(B) Only one ratio will decrease.

(C) Both ratios will decrease.

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

(A) 0.69.

(B) 1.44.

(C) 2.25.

40. An analyst using vertical common-size analysis is most likely to express each item on an income statement as a percentage of:
   (A) sales.
   (B) operating income.
   (C) its value in a base period.

41. A firm has a cash conversion cycle of 80 days. The firm's payables turnover goes from 11 to 12, what happens to the firm's cash conversion cycle? It:
   (A) lengthens.
   (B) may shorten or lengthen.
   (C) shortens.

42. In 20X8, Oliver Ltd. received $80,000 cash from a customer for goods that it could not deliver until the next year and established a liability for unearned revenue. Oliver reports under U.S. GAAP, faces a 40% tax rate, and is located in a tax jurisdiction where unearned revenue is taxed as received. On their balance sheet for 20X8, what change in deferred tax should Oliver record as a result of this transaction?
   (A) A deferred tax asset of $32,000.
   (B) A deferred tax liability of $32,000.
   (C) There is no effect on deferred tax items from this transaction.

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

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

The company's after-tax return on common equity is *closest to:*
   (A) 15%.
   (B) 20%.
   (C) 25%.

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

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

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

What is the quick ratio for 2004?

(A) 3.018

(B) 0.331.

(C) 2.018.

45. A firm buys an asset with an estimated useful life of five years for $100,000 at the beginning of the year. The firm will depreciate the asset on a straight-line basis with no salvage value on its financial statements and will use double declining balance depreciation for tax. The tax base for this asset at the end of the first year is closest to:
   (A) $40,000.
   (B) $80,000.
   (C) $60,000.

46. With other variables remaining constant, if a firm's asset turnover increases, its return on equity:
   (A) may increase, decrease, or remain the same.
   (B) will decrease.
   (C) will increase.

47. Both IFRS and U.S. GAAP allow deferred taxes to be:
   (A) recognized in equity after a fixed asset revaluation.
   (B) presented as noncurrent on the balance sheet.
   (C) measured using a substantially enacted tax rate.

48. The Puchalski Company reported the following:

	Year 1	Year 2	Year 3	Year 4
Income before taxes	$1,000	$1,000	$900	$800
Taxable income	$800	$900	$900	$1,000

The differences between income before taxes and taxable income are the result of using accelerated depreciation for tax purposes on an asset purchased in Year 1. Puchalski had no deferred tax liability prior to Year 1. If the tax rate is 40%, what is the amount of the deferred tax liability reported at the end of Year 4?
   (A) $40.
   (B) $80.
   (C) $120.

49. Deferred tax items should be measured based on the:
   (A) firm's effective tax rate at the time when the temporary difference reverses.
   (B) statutory tax rate at the time when the temporary difference is recognized.
   (C) tax rate that will apply when the temporary difference reverses.

50. 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:
   (A) increase Fred's income tax expense by $120,000.
   (B) increase Fred's income tax expense by $400,000.
   (C) decrease Fred's income tax expense by $120,000.

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

(A) $12.0 million.

(B) $4.5 million.

(C) $7.5 million.

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

(A) 46.5 days.

(B) 1.7 days.

(C) 219.0 days.

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

(A) 25 days.

(B) 20 days.

(C) 12 days.

54. If timing differences that give rise to a deferred tax liability are not expected to reverse then the deferred tax:

(A) must be reduced by a valuation allowance.

(B) should be considered an asset or liability.

(C) should be considered an increase in equity.

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

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

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

With respect to these statements:

(A) both are correct.

(B) both are incorrect.

(C) only one is correct:

56. A firm purchased a piece of equipment for $6,000 with the following information provided:
- Revenue will be $15,000 per year.
- The equipment has a 3-year life expectancy and no salvage value.
- The firm's tax rate is 30%.
- Straight-line depreciation is used for financial reporting and double declining is used for tax purposes.

Calculate taxes payable for years 1 and 2.

	Year 1	Year 2
(A)	3,300	4,100
(B)	3,900	3,900
(C)	600	-200

57. Enduring Corp. 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:

(A) 22.86% and increase its deferred tax liability by $1,000,000.

(B) 26.67% and increase its deferred tax liability by $1,000,000.

(C) 22.86% and increase its deferred tax asset by $1,000,000.

58. The traditional DuPont equation decomposes return on equity as:

(A) net income/assets x sales/equity x assets/sales.

(B) net income/sales x sales/assets x assets/equity.

(C) EBIT/sales x sales/assets x assets/equity x (1 - tax rate).

59. An analyst has gathered the following information about a firm:
- Quick ratio of 0.25.
- Cash ratio of 0.20.
- $2 million in marketable securities.
- $10 million in cash.

What is their receivables balance?

(A) 3 million.

(B) 5 million.

(C) 2 million.

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

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

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

What is the gross profit margin?

(A) 0.333.

(B) 0.472.

(C) 0.666.

61. Which of the following statements best describes the impact of a valuation allowance on the financial statements? A valuation allowance:
   (A) increases reported income, reduces assets, and reduces equity.
   (B) reduces reported income, increases liabilities, and reduces equity.
   (C) reduces reported income, reduces assets, and reduces equity.

62. Which of the following items is NOT in the numerator of the quick ratio?
   (A) Receivables
   (B) Inventory.
   (C) Cash.

63. Alter Inc. 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:
   (A) $3,500.
   (B) $31,500.
   (C) $35,000.

64. 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?
   (A) U.S. GAAP, but not IFRS.
   (B) IFRS, but not U.S. GAAP.
   (C) Neither IFRS nor U.S. GAAP.

65. A tax loss carryforward is best described as the:
   (A) net taxable loss that can be used to reduce taxable income in the future.
   (B) difference between deferred tax liabilities and deferred tax assets.
   (C) net taxable loss that can be used to recover taxes paid previously.

66. Which of the following ratios is a component of the original (three-part) DuPont equation?
   (A) Asset turnover.
   (B) Gross profit margin.
   (C) Debt-to-equity ratio.

67. Comparing a company's ratios with those of its competitors is best described as:
   (A) longitudinal analysis.
   (B) cross-sectional analysis.
   (C) common-size analysis.

68. An analyst has collected the following data about a firm:
- Receivables turnover = 20 times.
- Inventory turnover = 16 times.
- Payables turnover = 24 times.

What is the cash conversion cycle?

(A) Not enough information is given.
(B) 56 days.
(C) 26 days.

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

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

70. Given the following information about a firm:
- Revenues = $1,000.
- Cost of Goods Sold = $600.
- Operating Expenses = $200.
- Interest Expenses = $50.
- Tax Rate = 34%.

The operating profit margin is closest to:

(A) 20%.
(B) 40%.
(C) 10%.

71. This year, Blue Horizon has recorded $390,000 in revenue for financial reporting purposes, but, on a cash basis, revenue was only $262,000. Assume expenses at 50% in both cases (i.e., $195,000 on accrual basis and $131,000 on cash basis), and a tax rate of 34%. What is the deferred tax liability or asset? A deferred tax:

(A) asset of $21,760.
(B) liability of $21,760.
(C) liability of $16,320.

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

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

73. Camphor Associates uses accrual basis for financial reporting purposes and cash basis for tax purposes. Cash collections from customers is $238,000, and accrued revenue is only $188,000. Assume expenses at 50% in both cases (i.e., $119,000 on cash basis and $94,000 on accrual basis), and a tax rate of 34%. What is the deferred tax asset/liability in this case? A deferred tax:
    (A) asset of $8,500.
    (B) asset of $48,960.
    (C) liability of $8,500.

74. Which of the following statements is CORRECT? Income tax expense:
    (A) includes taxes payable and deferred income tax expense.
    (B) is the reported net of deferred tax assets and liabilities.
    (C) is the amount of taxes due to the government.

75. A firm's financial statements reflect the following:

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

Which of the following is the closest estimate of the firm's sustainable growth rate?
    (A) 10%.
    (B) 8%.
    (C) 9%.

76. Ratio analysis is most useful for comparing companies:
    (A) in different industries that use the same accounting standards.
    (B) of different size in the same industry.
    (C) that operate in multiple lines of business.

77. An analyst gathered the following information about a company:
- Pretax income = $10,000.
- Taxes payable = $2,500.
- Deferred taxes = $500.
- Tax expense = $3,000.

What is the firm's reported effective tax rate?
    (A) 30%.
    (B) 5%.
    (C) 25%.

78. A firm purchased a piece of equipment for $6,000 with the following information provided:

- Revenue will increase by $15,000 per year.
- The equipment has a 3-year life expectancy and no salvage value.
- The firm's tax rate is 30%.
- Straight-line depreciation is used for financial reporting and double declining is used for tax purposes.

What will the firm report for deferred taxes on the balance sheet for years 1 and 2?

	Year 1	Year 2
(A)	$3,900	$3,900
(B)	$600	$400
(C)	$3,300	$4,100

79. An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

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

What is the ROE?

(A) 10.7%.

(B) 9.9%.

(C) 9.3%.

80. Nespa, Inc., has a deferred tax liability on its balance sheet in the amount of $25 million. A change in tax laws has increased future tax rates for Nespa. The impact of this increase in tax rate will be:

(A) an increase in deferred tax liability and an increase in tax expense.

(B) a decrease in deferred tax liability and a decrease in tax expense.

(C) a decrease in deferred tax liability and an increase in tax expense.

81. Permanent differences between taxable and pretax income:

(A) are considered as changes in the effective tax rate.

(B) can be deferred in some cases.

(C) are not addressed specifically in the financial statements.

82. Which of the following statements regarding the disclosure of deferred taxes in a company's balance sheet is most accurate?

(A) Deferred tax assets and liabilities are classified as noncurrent.

(B) There should be a combined disclosure of all deferred tax assets and liabilities that are likely to reverse in the current period.

(C) Current deferred tax liability and noncurrent deferred tax asset are netted, resulting in the disclosure of a net noncurrent deferred tax liability or asset.

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

(A) 1 time.

(B) 3 times.

(C) 4 times.

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

	E Company	G Company
Sales	70	90
Cost of Goods Sold	(30)	(40)
Gross Profit	40	50
Sales and Administration	(5)	(15)

Depreciation	(5)	(10)
Operating Profit	30	25
Interest Expense	(20)	(5)
Earnings Before Taxes	10	20
Income Taxes	(4)	(8)
Earnings after Taxes	6	12

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

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

(B) higher than G Company's because its interest coverage ratio is less than one-third of G Company's.

(C) lower than G Company's because its interest coverage ratio is at least three times G Company's.

85.

Year:	2002	2003	2004
Income Statement:			
Revenues after all expenses other than depreciation	$200	$300	$400
Depreciation expense	50	50	50
Income before Income taxes	$150	$250	$350
Tax return:			
Taxable income Before depreciation expense	$200	$300	$400
Depreciation expense	75	50	25
Taxable income	$125	$250	$375

Assume an income tax rate of 40%.

The company's income tax expense for 2002 is:

(A) $0.

(B) $50.

(C) $60.

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

(A) Gross profit/net sales.

(B) Net income/net sales.

(C) Sales/Total Assets.

87. An analyst has gathered the following tax information:

	Year 1	Year 2
Pretax Income	$60,000	$60,000
Taxable Income	$50,000	$65,000

Assume all the differences between pretax income and taxable income are expected to reverse in the future.

The current tax rate is 40%. The tax rate is reduced to 30% and the change is enacted at the beginning of Year 2.

In year 1, what are the taxes payable and what is the deferred tax liability (DTL)?

	Taxes payable	DTL
(A)	$20,000	$3,000
(B)	$24,000	$1,500
(C)	$20,000	$1,500

88. When analyzing a company's financial leverage, deferred tax liabilities are best classified as:

(A) a liability or equity, depending on the company's particular situation.

(B) a liability.

(C) neither as a liability, nor as equity.

89.

Year ending 31 December:	2002	2003	2004
Income Statement:			
Revenues after all expenses other than depreciation	$200	$300	$400
Depreciation expense	50	50	50
Income before Income taxes	$150	$250	$350
Tax return:			
Taxable income Before depreciation expense	$200	$300	$400
Depreciation expense	75	50	25
Taxable income	$125	$250	$375

Assume an income tax rate of 40% and zero deferred tax liability on 31 December 2001.

The deferred tax liability to be shown in the 31 December 2003, balance sheet and the 31 December 2004 balance sheet, is:

	2003	2004
(A)	$0	$10
(B)	$10	$0
(C)	$25	$20

90. Given the following income statement:

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

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

	Interest Coverage Ratio	Net Profit Margin
(A)	0.57	0.56
(B)	7.67	0.30
(C)	2.63	0.30

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

- Current liabilities 20%
- Equity 45%

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

(A) 88%

(B) 78%

(C) 98%

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

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

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

(A) 46 days.

(B) 82 days.

(C) 86 days.

93. Which of the following statements regarding deferred taxes is NOT correct?
   (A) If deferred taxes are not expected to reverse in the future then they should be classified as equity.
   (B) Only those components of deferred tax liabilities that are likely to reverse should be considered a liability.
   (C) If deferred tax liabilities are not included in equity, debt-to-equity ratio will be reduced.

94. An analyst has gathered the following information about a company:
   - Cost of goods sold = 65% of sales.
   - Inventory of $450,000.
   - Sales of $1 million.

   What is the value of this firm's average inventory processing period using a 365-day year?
   (A) 0.7 days.
   (B) 1.4 days.
   (C) 252.7 days.

95. Companies are required to report segment data under:
   (A) both IFRS and U.S. GAAP.
   (B) U.S. GAAP but not !FRS.
   (C) IFRS but not U.S. GAAP.

96. An analyst gathered the following information about a company:
   - Taxable income = $100,000.
   - Pretax income = $120,000.
   - Current tax rate = 20%.

   Assuming the difference between taxable income and pretax income will reverse in the future, the effect these events on the company's financial statements will be to report income tax expense of:
   (A) $24,000 and a decrease in deferred tax assets of $4,000.
   (B) $22,000 with no change in deferred tax items.
   (C) $24,000 and an addition to deferred tax liabilities of $4,000.

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

98. Which of the following statements about deferred taxes is most accurate? Deferred tax liabilities:
   (A) arise primarily due to differences between financial and tax accounting.
   (B) can relate to either permanent or temporary differences.
   (C) should be treated as debt when calculating financial statement ratios.

99. Which of the following statements regarding deferred taxes is /east accurate?
   (A) Deferred tax assets and liabilities are not adjusted for changes in tax rates.
   (B) A deferred tax asset is created when a temporary difference results in taxable income that exceeds pretax income.
   (C) A permanent difference is a difference between taxable income and pretax income that will not reverse.

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

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

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

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

(A) 1.83.

(B) 0.62.

(C) 0.29.

101. A firm's financial statements reflect the following:

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

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

Current Ratio	Quick Ratio	Cash Ratio
(A) 0.8	0.6	1.1
(B) 1.1	0.8	0.6
(C) 1.1	0.6	0.8

102. An analyst gathered the following data about a company:

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

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

(A) decrease current assets by 100 or increase current liabilities by 50.

(B) increase current assets by 100 or decrease current liabilities by 50.

(C) increase current assets by 100 or increase current liabilities by 50.

103. Laser Tech has net temporary differences between tax and book income resulting in a deferred tax liability of $30.6 million. According to U.S. GAAP, an increase in the tax rate would have what impact on deferred taxes and net income, respectively:

Deferred Taxes	Net Income
(A) Increase	No effect
(B) Increase	Decrease
(C) No effect	Decrease

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

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

With respect to these statements:

(A) both are correct.

(B) both are incorrect.

(C) only one is correct.

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

(A) $120,000,000.

(B) $83,333,333.

(C) $1,200,000.

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

(A) Interest coverage.

(B) Total asset turnover.

(C) Current ratio.

107. 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.

(A) $150 million increase.

(B) $50 million increase.

(C) $80 million increase.

108. A dance club purchases new sound equipment for $25,352. It will work for 5 years and has no salvage value. For financial reporting, the straight-line depreciation method is used, but for tax purposes depreciation is 35% of original cost in years 1 and 2 and the remaining 30% in Year 3. Annual revenues are constant at $14,384 over these five years. If the tax rate for years 4 and 5 changes from 41% to 31%, what is the deferred tax liability as of the end of year 3?

(A) $2,948.

(B) $3,144.

(C) $1,039.

109. For analytical purposes, if a deferred tax liability is expected to not be reversed, it should be treated as a(n):

(A) an addition to equity.

(B) immaterial amount and ignored.

(C) liability.

110. Which of the following factors is least likely o cause a difference between a firm's effective tax rate and statutory rate?

(A) Tax credits.

(B) Deductible expenses.

(C) Non-deductible expenses.

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

(A) Calculation of ratios involves a large degree of subjectivity.

(B) Determining the target or comparison value for a ratio is difficult.

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

112. 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:

(A) decrease income tax expense.

(B) increase income tax expense.

(C) have no effect on income tax expense.

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

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

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

	Transaction #1	Transaction #2
(A)	Higher	Higher
(B)	Higher	Lower
(C)	Lower	Higher

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

(A) Tax burden.

(B) Interest burden.

(C) Financial leverage.

Explanation

115. Graphics, Inc. has a deferred tax asset of $4,000,000 on its books. As of December 31, it became more likely than not that $2,000,000 of the asset's value may never be realized because of the uncertainty of future income. Graphics, Inc. should:

(A) not make any adjustments until it is certain that the tax benefits will not be realized.

(B) reverse the asset account permanently by $2,000,000.

(C) reduce the asset by establishing a valuation allowance of $2,000,000 against the asset.

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

(A) 3.25.

(B) 2.89.

(C) 3.71.

117. If a firm uses accelerated depreciation for tax purposes and straight-line depreciation for financial reporting, which of the following results is least likely?

(A) A permanent difference will result between tax and financial reporting.

(B) A temporary difference will result between tax and financial reporting.

(C) Income tax expense will be greater than taxes payable.

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

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

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

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

Sensitivity analysis Scenario analysis

(A)	Description #3	Description #2
(B)	Description #2	Description #3
(C)	Description #3	Description #1

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

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

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

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

120. An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750

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

What is the receivables collection period?

(A) 183.

(B) 243.

(C) 365.

121. A company purchased a new pizza oven for $12,676. It will work for 5 years and has no salvage value. The tax rate is 41%, and annual revenues are constant at $7,192. For financial reporting, the straight-line depreciation method is used, but for tax purposes depreciation is 35% of original cost in years 1 and 2 and the remaining 30% in Year 3. For this question ignore all expenses other than depreciation.

What is the deferred tax liability as of the end of year one?

(A) $780.

(B) $1,129.

(C) $1,909.

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

(A) 37 days.

(B) 30 days.

(C) 79 days.

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

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

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

(A) Jerome has the least uncertainty about its net income.

(B) Morris has the greatest uncertainty about its sales.

(C) Lawrence has the greatest uncertainty about its net income.

124. A company purchased a new pizza oven for $12,676. It will work for 5 years and has no salvage value. The tax rate is 41%, and annual revenues are constant at $7,192. For financial reporting, the straight-line depreciation method is used, but for tax purposes depreciation is 35% of original cost in years 1 and 2 and the remaining 30% in Year 3. For this question ignore all expenses other than depreciation.

What is the tax payable for year one?

(A) $779.

(B) $1,130.

(C) $1,909.

125. Habel Inc. owns equipment with a tax base of $400,000 and a carrying value of $600,000. Habel also has a tax loss carryforward of $200,000 that is expected to be utilized in the foreseeable future. Deferred tax items on the balance sheet are based on a tax rate of 30%. Based only on this information, an increase in future tax rates to 35% will cause Habel's total equity ratio to:

(A) remain unchanged.

(B) increase.

(C) decrease.

126. A firm needs to adjust its financial statements for a change in the tax rate. Taxable income is $80,000 and pretax income is $120,000. The current tax rate is 50%, and the new tax rate is 40%. The effect on taxes payable of adjusting the tax rate is closest to:

(A) $4,000.

(B) $8,000.

(C) $16,000.

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

	Net profit margin	Dividend payout ratio
(A)	Yes	Yes
(B)	Yes	No
(C)	No	No

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

Revenue / Average working capital	Average total assets / Average total equity
(A) Activity ratio	Liquidity ratio
(B) Activity ratio	Solvency ratio
(C) Profitability ratio	Solvency ratio

129. An analyst has gathered the following information about a company:

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

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

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

What is the current ratio?

(A) 0.22.

(B) 2.67.

(C) 4.65.

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

	12/31 /20X4	12/31 /20X3
Assets		
Cash	2,098	410
Accounts receivable	4,570	4,900
Inventory	4,752	4,500
Prepaid SGA	877	908
Total current assets	12,297	10,718
Land	0	4,000
Property, Plant & Equipment	11,000	11,000
Accumulated Depreciation	(5,862)	(5,200)
Total Assets	17,435	20,518

Liabilities and Equity		
Accounts Payable	4,651	5,140
Wages Payable	2,984	2,890
Dividends Payable	100	100
Total current liabilities	7,735	8,130
Long term Debt	1,346	7,388
Common Stock	4,000	4,000
Retained Earnings	4,354	1,000
Total Liabilities and Equity	17,435	20,518

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

	Current ratio	Quick ratio
(A)	1.48	0.86
(B)	1.59	0.86
(C)	1.59	1.59

131. Given the following data regarding two firms under different scenarios, determine the amount of any deferred tax liability or asset.

Firm 1:

Tax Reporting		Financial Reporting	
Revenue	$5,00,000	Revenue	$5,00,000
Depreciation	$100,000	Depreciation	$50,000
Taxable income	$400,000	Pretax income	$4,50,000
Taxes payable	$1,60,000	Tax expense	$1,80,000
Net income	$2,40,000	Net income	$2,70,000

Firm 2:

Tax Reporting		Financial Reporting	
Revenue	$500,000	Revenue	$500,000
Warranty expense	$0	Warranty expense	$10,000
Taxable income	$500,000	Pretax income	$490,000
Taxes payable	$200,000	Tax expense	$196,000
Net income	$300,000	Net income	$294,000

	Firm 1 Deferred Tax	Firm 2 Deferred Tax
(A)	$20,000 Liability	$4,000 Asset
(B)	$30,000 Asset	$6,000 Asset
(C)	$20,000 Asset	$6,000 Liability

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

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

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

What is the operating profit margin?

(A) 0.45

(B) 0.50.

(C) 0.67.

133. A company purchased a new pizza oven directly from Italy for $12,676. It will work for 5 years and has no salvage value. The tax rate is 41 %, and annual revenues are constant at $7,192. For financial reporting, the straight-line depreciation method is used, but for tax purposes depreciation is accelerated to 35% in years 1 and 2, and 30% in year 3. For purposes of this exercise ignore all expenses other than depreciation.

What is the net income and depreciation expense for year one for financial reporting purposes?

	Net Income	Depreciation Expense
(A)	$2,535	$3,169
(B)	$4,657	$2,748
(C)	$2,748	$2,535

134. Firm 1 has a deferred tax liability and Firm 2 has a deferred tax asset. If the tax rate decreases, the balance sheet values of these deferred tax items will:

	Firm 1	Firm 2
(A)	decrease.	decrease.
(B)	increase.	decrease.
(C)	increase.	increase.

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

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

(B) Net profit margin, asset turnover, equity multiplier.

(C) Gross profit margin, asset turnover, equity multiplier.

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

(A) 2.50.

(B) 3.15.

(C) 1.85.

137. All-Star Enterprises purchased a machine on January 1. The company uses straight-line depreciation for financial reporting and accelerated depreciation for tax purposes. Depreciation for tax purposes during the year was $36,000 greater than depreciation for financial reporting. Assuming a 30% tax rate will apply in the future, how much will be recorded as a deferred tax liability during the year?

(A) $10,800

(B) $25,200

(C) $36,000

138. Unit Technologies uses accrual basis for financial reporting purposes and cash accounting for tax purposes. So far this year, Unit Technologies has recorded $195,000 in revenue for financial reporting purposes, but, on a cash basis, revenue was only $131,000. Assume expenses at 50 percent in both cases (i.e., $ 97,500 on accrual basis and $ 65,500 on cash basis), and a tax rate of 34%. What is the deferred tax liability or asset? A deferred tax:

(A) liability of $16,320.

(B) asset of $10,880.

(C) liability of $10,880.

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

(A) $22.0 million.

(B) $8.0 million.

(C) $8.8 million.

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

(A) Equity Turnover.

(B) Net Profit Margin.

(C) Current Ratio.

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

Earnings after taxes	= 18%
Equity	= 40%
Current assets	= 60%
Current liabilities	= 30%
Sales	= $300
Total assets	= $1,400

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

(A) 9.6%.

(B) 5.0%.

(C) 18.0%.

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

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

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

(A) Entertainment, Lodging, and Services.

(B) Services and International.

(C) International only.

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

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

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

Total Asset Turnover   Return on Equity

	Total Asset Turnover	Return on Equity
(A)	1.25	20.8%
(B)	1.33	15.8%
(C)	1.33	20.8%

144. An analyst has gathered the following information about a firm:

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

What is this firm's operating profit margin?

(A) 18%.

(B) 30%.

(C) 50%.

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

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

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

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

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

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

146. Which of the following statements regarding differences between taxable and pretax income is most accurate? Differences between taxable and pretax income that:

(A) are not reversed for five or more years are called permanent differences.

(B) increase or decrease the effective tax rate are called temporary differences.

(C) result in deferred tax assets or liabilities are called temporary differences.

147. The following data apply to the XTC Company:

- Sales = $1,000,000.
- Receivables = $260,000.
- Payables = $600,000.

- Purchases = $800,000.
- COGS = $800,000.
- Inventory = $400,000.
- Net Income = $50,000.
- Total Assets = $800,000.
- Debt/Equity = 200%.

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

(A) 45 days of inventory on hand.

(B) 95 days of sales outstanding.

(C) 132 days of payables.

148. An analyst has gathered the following data about a company:
- Days' sales outstanding of 37 days.
- Days' payables of 30 days.
- Days of inventory on hand of 46 days.

What is their cash conversion cycle?

(A) 113 days.

(B) 45 days.

(C) 53 days.

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

(A) $36,000.

(B) $40,000.

(C) $360,000.

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

(A) 4.55%.

(B) 4.95%.

(C) 5.81%.

151. 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:

(A) both IFRS and U.S. GAAP.

(B) IFRS, but not U.S. GAAP.

(C) U.S. GAAP, but not IFRS.

152. Corcoran Corp acquired an asset on 1 January 2004, for $500,000. For financial reporting, Corcoran will depreciate the asset using the straight-line method over a 10-year period with no salvage value. For tax purposes the asset will be depreciated straight line for five years and Corcoran's effective tax rate is 30%. Corcoran's deferred tax liability for 2004 will:

(A) decrease by $15,000.

(B) decrease by $50,000.

(C) increase by $15,000.

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

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

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

What is the average receivables collection period?

(A) 60.6 days.

(B) 76.7 days.

(C) 80.3 days.

154. A firm's financial statements reflect the following:

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

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

(A) 10.63%

(B) 8.82%.

(C) 7.35%.

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

(A) non-current assets.

(B) inventory.

(C) marketable securities.

156. While evaluating the financial statements of Omega, Inc., the analyst observes that the effective tax rate is 7% less than the statutory rate. The source of this difference is determined to be a tax holiday on a manufacturing plant located in South Africa. This item is most likely to be:

(A) continuous in nature, so the termination date is not relevant.

(B) sporadic in nature, and the analyst should try to identify the termination date and determine if taxes will be payable at that time.

(C) sporadic in nature, but the effect is typically neutralized by higher home country taxes on the repatriated profits.

157. Goldstar Manufacturing has an accounts receivable turnover of 10.5 times, an inventory turnover of 4 times, and payables turnover of 8 times. What is Goldstar's cash conversion cycle?
   - (A) 171.64 days.
   - (B) 6.50 days.
   - (C) 80.38 days.

158. A company has a cash conversion cycle of 80 days. If the company's average receivables turnover increases from 11 to 12, the company's cash conversion cycle:
   - (A) decreases by approximately 1 day.
   - (B) decreases by approximately 3 days.
   - (C) increases by approximately 3 days.