Question #1 of 35

An analyst finds return-on-equity (ROE) (based on beginning of the year equity) a good measure of management performance and wants to compare two firms: Firm A and Firm B. Firm A reports net income of $3.2 million and has a ROE of 18. Firm B reports income of $16 million and has an ROE of 16.

A review of the notes to the financial statements for Firm A, shows that the earnings include a loss from smelting operations of $400,000 and that the firm has exited this business. In addition, the firm sold the smelting equipment and had a gain on the sale of $300,000.

A similar review of the notes for Firm B discloses that the $16 million in net income includes $2.6 million gain on the sale of no longer needed office property. Assume that the tax rate for both firms is 36%, and that the notes describe pre-tax amounts. Which of the following is *closest* to the "normalized" ROE for Firm A and for Firm B, respectively?

A) 17.1 and 16.9.

B) 18.4 and 14.3.

C) 16.0 and 18.0.

Question #2 of 35

Holdall Corporation recently reclassified many of their assets such that the average useful life of their depreciable assets was reduced. Which of the following is the *most likely* result from this change on net income and inventory turnover? (Assume everything else remains constant.) Net income will:

A) decrease and inventory turnover will rise.

B) increase and inventory turnover will not change.

C) decrease and inventory turnover may or may not change.

Question #3 of 35

An analyst is developing a framework for financial statement analysis for his firm. This framework is *most likely* to include:

A) Define the purpose of the analysis, process input data, and follow up.

B) Determine the allocation of firm fees, interpret processed data, and communicate conclusions.

C) Maintain integrity of capital markets, perform duties to clients and employers, and avoid conflicts of interest.

Question #4 of 35

Wanda Brunner, CFA, is analyzing Straight Elements, Inc., (SE). SE is a discount manufacturer of parts and supplies for the railroad industry. She has followed her firm's suggested financial analysis framework, and has assembled output from processing data. When applying the financial analysis framework, which of the following is the *best* example of output from processing data?

A) Audited financial statements.

B) Common-size financial statements.

C) A written list of questions to be answered by the analysis.

Question #5 of 35

Which of the following statements is CORRECT when inventory prices are falling?

A) LIFO results in lower COGS, lower earnings, lower taxes, and higher cash flows.

B) LIFO results in higher COGS, lower earnings, higher taxes, and higher cash flows.

C) LIFO results in lower COGS, higher earnings, higher taxes, and lower cash flows.

Question #6 of 35

ABC Tie Company reports income for the year 2009 as $450,000. The notes to its financial statements state that the firm uses the last in, first out (LIFO) convention to value its inventories, and that had it used first in, first out (FIFO) instead, inventories would have been $62,000 greater for the year 2008 and $78,000 greater for the year 2009. If earnings were restated using FIFO to determine the cost of goods sold (COGS), what would the net income be for the year 2009? Assume a tax rate of 36%. Net income would have been:

A) $455,760.

B) $439,760.

C) $460,240.

Question #7 of 35

Assume that inventory costs are increasing in line with an overall inflation rate of 3 percent. If a firm reports inventory using the last in, first out (LIFO) method, which of the following is *most* accurate?

A) The less expensive inventory is flowing out to COGS.

B) Lower profits and lower taxes are reported because new inventory is flowing out to COGS.

C) LIFO reserve measures the accumulation of taxes paid.

Question #8 of 35

Star Chemical Inc. (SCI) reported the following year-end data:

Depreciation expense	$25 million
Net income	$35 million
Dividends	$10 million
Total assets	$250 million
Shareholder's equity	$195 million
Effective tax rate	35 percent

SCI also reported that it changed from an accelerated depreciation method to straight line depreciation. The change resulted in a decrease in depreciation expense of $5 million. Management felt that the change "would not have a material effect on financial performance measures." Ignoring deferred taxes, what are the return on assets (ROA) and return on equity (ROE) measures under the old depreciation methods?

A) ROA is 12.96% and ROE is 16.56%.

B) ROA is 13.30% and ROE is 17.05%.

C) ROA is 13.50% and ROE is 17.51%.

Question #9 of 35

SnapPrints and NetPhoto Case Scenario

Josephine Howard, CFA is an equity analyst for an investment bank. She is preparing financial reports for two publicly traded digital photography companies, SnapPrints and Net Photo. Howard just attended a CFA Institute sponsored conference on detecting quality issues in financial statements and is eager to apply what she has learned.

SnapPrints provides photo prints and various other photo-related products, including calendars, T-shirts, and coffee mugs. NetPhoto is SnapPrints' largest competitor. NetPhoto has been receiving increasing attention from the analyst community due to its high sales growth rate, although NetPhoto's sales are still less than 50% of SnapPrints' sales.

During the conference, Howard learned about the importance of analyzing accruals to evaluate earnings quality. Therefore, Howard is going to analyze the accruals for each company as part of her review. Howard remembers a discussion from the conference about disaggregating income into its major components to improve earnings forecasts, but she cannot remember which component (cash or accruals) should receive a higher weighting in the forecast.

Howard gathered the following data from the income statement and statement of cash flows for SnapPrints.

Selected SnapPrints Income StatementItems (000s) Year Ended December 31, 2009	
Sales	45,000
Cost of Good Sold	(30,000)
Depreciation Expense	(3,000)
SG&A Expense	(2,000)
Interest Expense	(1,500)
Income Tax Expense	(3,000)
Net Income	**5,500**

Cash Flows for SnapPrints (000s) Year Ended December 31, 2009	
Cash from Operations	6,500
Cash from Investing	(3,500)
Cash from Financing	(1,200)
Change in Cash	**1,800**

Howard collected the following balance sheet data for NetPhoto.

Selected Balance Sheet items for NetPhoto as of December 31, in $Ms						
	2009	**2008**			**2009**	**2008**
Cash	5,500	4,500		Accounts Payable	4,500	4,300
Accounts Receivable	6,500	5,500		Short-term Notes Payable	5,800	6,500
Inventory	11,500	14,000		Long-Term Debt	28,500	29,750
Fixed Assets, Net	35,000	34,300		*Total Liabilities*	*38,800*	*40,550*
				Common Stock	15,000	12,800
				Retained Earnings	4,700	4,950
Total Assets	*58,500*	*58,300*		*Total Liabilities and Equity*	*58,500*	*58,300*

Howard has concerns about revenue recognition practices at both firms and has collected the following data.

	2009	**2008**	**2007**	**2006**
SnapPrints				
Revenue	45,000	44,000	44,400	38,500
Cash Collections	43,000	45,000	44,000	37,000
NetPhoto				
Revenue	22,000	15,000	11,500	7,500
Cash Collections	11,000	12,000	8,500	7,000

Compared to aggregate accruals, the accrual ratio is especially useful when:

A) comparing year-over-year accruals.

B) the cash component is large.

C) comparing across companies.

Question #10 of 35

Due to a change in accounting standards, TRK Construction's QSPE must now be consolidated. The QSPE has purchased, TRK's accounts receivables and had financed those with short-term notes payables. Assume that TRK's current ratio before consolidation is 1.10. Consolidation will *most likely* result in which of the following:

A) a decrease in the current ratio.

B) no change in the current ratio.

C) an increase in the current ratio.

Question #11 of 35

SnapPrints and NetPhoto Case Scenario

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SnapPrints provides photo prints and various other photo-related products, including calendars, T-shirts, and coffee mugs. NetPhoto is SnapPrints' largest competitor. NetPhoto has been receiving increasing attention from the analyst community due to its high sales growth rate, although NetPhoto's sales are still less than 50% of SnapPrints' sales.

During the conference, Howard learned about the importance of analyzing accruals to evaluate earnings quality. Therefore, Howard is going to analyze the accruals for each company as part of her review. Howard remembers a discussion from the conference about disaggregating income into its major components to improve earnings forecasts, but she cannot remember which component (cash or accruals) should receive a higher weighting in the forecast.

Howard gathered the following data from the income statement and statement of cash flows for SnapPrints.

Selected SnapPrints Income StatementItems (000s) Year Ended December 31, 2009	
Sales	45,000
Cost of Good Sold	(30,000)
Depreciation Expense	(3,000)
SG&A Expense	(2,000)
Interest Expense	(1,500)
Income Tax Expense	(3,000)
Net Income	**5,500**

Cash Flows for SnapPrints (000s) Year Ended December 31, 2009	
Cash from Operations	6,500
Cash from Investing	(3,500)
Cash from Financing	(1,200)
Change in Cash	**1,800**

Howard collected the following balance sheet data for NetPhoto.

Selected Balance Sheet items for NetPhoto as of December 31, in $Ms						
	2009	**2008**			**2009**	**2008**
Cash	5,500	4,500		Accounts Payable	4,500	4,300
Accounts Receivable	6,500	5,500		Short-term Notes Payable	5,800	6,500
Inventory	11,500	14,000		Long-Term Debt	28,500	29,750
Fixed Assets, Net	35,000	34,300		*Total Liabilities*	*38,800*	*40,550*
				Common Stock	15,000	12,800
				Retained Earnings	4,700	4,950
Total Assets	*58,500*	*58,300*		*Total Liabilities and Equity*	*58,500*	*58,300*

Howard has concerns about revenue recognition practices at both firms and has collected the following data.

	2009	2008	2007	2006
SnapPrints				
Revenue	45,000	44,000	44,400	38,500
Cash Collections	43,000	45,000	44,000	37,000
NetPhoto				
Revenue	22,000	15,000	11,500	7,500
Cash Collections	11,000	12,000	8,500	7,000

In reviewing the footnotes to NetPhoto's financial statements, Howard discovers that the firm has engaged in a LIFO liquidation. The *most likely* effects on the financial statements (compared to no LIFO liquidation) are:

A) a decrease in inventory turnover and an increase in the gross profit margin.

B) an increase in the gross profit margin and an increase in days of inventory.

C) a decrease in COGS and an increase in the net profit margin.

Question #12 of 35

Millennium Airlines Corp. (MAC) reported the following year-end data:

Rent expense	$24 million
Depreciation expense	$17 million
EBIT	$88 million
Interest expense	$22 million
Total assets	$500 million
Long-term debt	$150 million
Capital lease obligations	$100 million
Total equity	$250 million

MAC also reported that the present value of its operating leases at the beginning of the year was $128 million at 10% interest rate. The term on the leases was 8 years. Ignoring taxes, what are the effects on the leverage (liabilities / total capital) and times interest earned if an analyst chooses to capitalize the leases using a straight-line depreciation (zero salvage, life = lease term) assumption? Leverage measures:

A) increase to 65% from 50% and times interest earned decreases to 1.78 times from 4 times.

B) remain unchanged and times interest earned decreases to 1.78 times from 4 times.

C) increase to 60% from 50% and times interest earned decreases to 2.76 times from 4 times.

Question #13 of 35

Lucky Strike Mining Corp. (LSMC) reports in a footnote to the financial statements that it is party to a variable interest entity (VIE) through which it leases heavy equipment. LSMC has chosen not to report a residual value guarantee of $120 million for the equipment because it is not required to do so under accounting standards. However, the standards will change next year. What is the appropriate analytical treatment of this residual value guarantee?

A) Increase long-term liabilities by $120 million and decrease equity by $120 million.

B) Ignore the liability because current accounting standards do not require it to be included on the balance sheet. Include it in next year's balance sheet adjustments.

C) Increase long-term liabilities and long-term assets by $120 million.

Question #14 of 35

SnapPrints and NetPhoto Case Scenario

Josephine Howard, CFA is an equity analyst for an investment bank. She is preparing financial reports for two publicly traded digital photography companies, SnapPrints and Net Photo. Howard just attended a CFA Institute sponsored conference on detecting quality issues in financial statements and is eager to apply what she has learned.

SnapPrints provides photo prints and various other photo-related products, including calendars, T-shirts, and coffee mugs. NetPhoto is SnapPrints' largest competitor. NetPhoto has been receiving increasing attention from the analyst community due to its high sales growth rate, although NetPhoto's sales are still less than 50% of SnapPrints' sales.

During the conference, Howard learned about the importance of analyzing accruals to evaluate earnings quality. Therefore, Howard is going to analyze the accruals for each company as part of her review. Howard remembers a discussion from the conference about disaggregating income into its major components to improve earnings forecasts, but she cannot remember which component (cash or accruals) should receive a higher weighting in the forecast.

Howard gathered the following data from the income statement and statement of cash flows for SnapPrints.

Selected SnapPrints Income StatementItems (000s) Year Ended December 31, 2009	
Sales	45,000
Cost of Good Sold	(30,000)
Depreciation Expense	(3,000)
SG&A Expense	(2,000)
Interest Expense	(1,500)
Income Tax Expense	(3,000)
Net Income	**5,500**

Cash Flows for SnapPrints (000s) Year Ended December 31, 2009	
Cash from Operations	6,500
Cash from Investing	(3,500)
Cash from Financing	(1,200)
Change in Cash	**1,800**

Howard collected the following balance sheet data for NetPhoto.

Selected Balance Sheet items for NetPhoto as of December 31, in $Ms						
	2009	**2008**			**2009**	**2008**
Cash	5,500	4,500		Accounts Payable	4,500	4,300
Accounts Receivable	6,500	5,500		Short-term Notes Payable	5,800	6,500
Inventory	11,500	14,000		Long-Term Debt	28,500	29,750
Fixed Assets, Net	35,000	34,300		*Total Liabilities*	*38,800*	*40,550*
				Common Stock	15,000	12,800
				Retained Earnings	4,700	4,950
Total Assets	*58,500*	*58,300*		*Total Liabilities and Equity*	*58,500*	*58,300*

Howard has concerns about revenue recognition practices at both firms and has collected the following data.

	2009	**2008**	**2007**	**2006**
SnapPrints				
Revenue	45,000	44,000	44,400	38,500
Cash Collections	43,000	45,000	44,000	37,000
NetPhoto				
Revenue	22,000	15,000	11,500	7,500
Cash Collections	11,000	12,000	8,500	7,000

Based on her calculations of accruals, Howard believes that NetPhoto has a higher accruals ratio over the recent past compared with SnapPrints. If both companies have recently had extreme earnings, Howard would *most likely* conclude that:

A) SnapPrints' income will revert to its mean, but NetPhoto's income will not.

B) NetPhoto's income will revert to its mean more quickly than SnapPrints'.

C) SnapPrints' income will revert to its mean more quickly than NetPhoto's.

Question #15 of 35

An analyst is analyzing a discount manufacturer of parts and supplies. She has followed her firm's suggested financial analysis framework and has communicated with company suppliers, customers, and competitors. This is an input that occurs while:

A) establishing the objective of the analysis.

B) processing data.

C) collecting data.

Question #16 of 35

SnapPrints and NetPhoto Case Scenario

Josephine Howard, CFA is an equity analyst for an investment bank. She is preparing financial reports for two publicly traded digital photography companies, SnapPrints and Net Photo. Howard just attended a CFA Institute sponsored conference on detecting quality issues in financial statements and is eager to apply what she has learned.

SnapPrints provides photo prints and various other photo-related products, including calendars, T-shirts, and coffee mugs. NetPhoto is SnapPrints' largest competitor. NetPhoto has been receiving increasing attention from the analyst community due to its high sales growth rate, although NetPhoto's sales are still less than 50% of SnapPrints' sales.

During the conference, Howard learned about the importance of analyzing accruals to evaluate earnings quality. Therefore, Howard is going to analyze the accruals for each company as part of her review. Howard remembers a discussion from the conference about disaggregating income into its major components to improve earnings forecasts, but she cannot remember which component (cash or accruals) should receive a higher weighting in the forecast.

Howard gathered the following data from the income statement and statement of cash flows for SnapPrints.

Selected SnapPrints Income Statement Items (000s) Year Ended December 31, 2009	
Sales	45,000
Cost of Good Sold	(30,000)
Depreciation Expense	(3,000)
SG&A Expense	(2,000)
Interest Expense	(1,500)
Income Tax Expense	(3,000)
Net Income	**5,500**

Cash Flows for SnapPrints (000s) Year Ended December 31, 2009	
Cash from Operations	6,500
Cash from Investing	(3,500)
Cash from Financing	(1,200)
Change in Cash	**1,800**

Howard collected the following balance sheet data for NetPhoto.

Selected Balance Sheet items for NetPhoto as of December 31, in $Ms						
	2009	**2008**			**2009**	**2008**
Cash	5,500	4,500		Accounts Payable	4,500	4,300
Accounts Receivable	6,500	5,500		Short-term Notes Payable	5,800	6,500
Inventory	11,500	14,000		Long-Term Debt	28,500	29,750
Fixed Assets, Net	35,000	34,300		*Total Liabilities*	*38,800*	*40,550*
				Common Stock	15,000	12,800
				Retained Earnings	4,700	4,950
Total Assets	*58,500*	*58,300*		*Total Liabilities and Equity*	*58,500*	*58,300*

Howard has concerns about revenue recognition practices at both firms and has collected the following data.

	2009	**2008**	**2007**	**2006**
SnapPrints				
Revenue	45,000	44,000	44,400	38,500
Cash Collections	43,000	45,000	44,000	37,000
NetPhoto				
Revenue	22,000	15,000	11,500	7,500
Cash Collections	11,000	12,000	8,500	7,000

The aggregate accruals (in $M's) for SnapPrints and the accrual ratio for NetPhoto are *closest* to:

A) −4,500 and −1.49%.

B) 3,700 and −0.51%.

C) 2,500 and −2.04%.

Question #17 of 35

An investor relations spokesperson for the Square Door Corporation was quoted as saying that Square Door shares were a bargain, selling at a price-to-earnings (P/E) ratio of 12, relative to the S&P 500 average P/E of 15.3. The financial statements reported net earnings of $126 million, or $4.00 per share. The notes to the financial statements included a statement that income for the year included a $31.5 million (after-tax) gain from the reclassification of certain assets from its investment portfolio to its trading portfolio. What would be the normalized P/E?

A) 13

B) 15.

C) 16

Question #18 of 35

Recently, Galaxy Corporation lowered its allowance for doubtful accounts by reducing bad debt expense from 2 percent of sales to 1 percent of sales. Ignoring taxes, what are the immediate effects on Galaxy's operating income and operating cash flow?

	Operating income	Operating cash flow
A)	Lower	Lower
B)	Higher	No effect
C)	No effect	Higher

Question #19 of 35

SnapPrints and NetPhoto Case Scenario

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SnapPrints provides photo prints and various other photo-related products, including calendars, T-shirts, and coffee mugs. NetPhoto is SnapPrints' largest competitor. NetPhoto has been receiving increasing attention from the analyst community due to its high sales growth rate, although NetPhoto's sales are still less than 50% of SnapPrints' sales.

During the conference, Howard learned about the importance of analyzing accruals to evaluate earnings quality. Therefore, Howard is going to analyze the accruals for each company as part of her review. Howard remembers a discussion from the conference about disaggregating income into its major components to improve earnings forecasts, but she cannot remember which component (cash or accruals) should receive a higher weighting in the forecast.

Howard gathered the following data from the income statement and statement of cash flows for SnapPrints.

Selected SnapPrints Income StatementItems (000s) Year Ended December 31, 2009	
Sales	45,000
Cost of Good Sold	(30,000)
Depreciation Expense	(3,000)
SG&A Expense	(2,000)
Interest Expense	(1,500)
Income Tax Expense	(3,000)
Net Income	**5,500**

Cash Flows for SnapPrints (000s) Year Ended December 31, 2009	
Cash from Operations	6,500
Cash from Investing	(3,500)
Cash from Financing	(1,200)
Change in Cash	**1,800**

Howard collected the following balance sheet data for NetPhoto.

Selected Balance Sheet items for NetPhoto as of December 31, in $Ms						
	2009	**2008**			**2009**	**2008**
Cash	5,500	4,500		Accounts Payable	4,500	4,300
Accounts Receivable	6,500	5,500		Short-term Notes Payable	5,800	6,500
Inventory	11,500	14,000		Long-Term Debt	28,500	29,750
Fixed Assets, Net	35,000	34,300		*Total Liabilities*	*38,800*	*40,550*
				Common Stock	15,000	12,800
				Retained Earnings	4,700	4,950
Total Assets	*58,500*	*58,300*		*Total Liabilities and Equity*	*58,500*	*58,300*

Howard has concerns about revenue recognition practices at both firms and has collected the following data.

	2009	**2008**	**2007**	**2006**
SnapPrints				
Revenue	45,000	44,000	44,400	38,500
Cash Collections	43,000	45,000	44,000	37,000
NetPhoto				
Revenue	22,000	15,000	11,500	7,500
Cash Collections	11,000	12,000	8,500	7,000

Based on the revenue and cash collections data for SnapPrints and NetPhoto, Howard would *most likely* conclude that:

A) SnapPrints is misclassifying nonrecurring and nonoperating revenue.

B) SnapPrints is accelerating revenue.

C) NetPhoto is accelerating revenue.

Question #20 of 35

A firm has reported net income of $136 million, but the notes to financial statements includes a statement that the results "include a $27 million charge for non-insured earthquake damage" and a "gain on the sale of certain assets during restructuring of $16 million." If we assume that both of these items are given on a pre-tax basis and the effective tax rate is 36%, what would be the "normal income"?

A) $94.08 million.

B) $143.04 million.

C) $147.00 million.

Question #21 of 35

Which of the following statements regarding adjustments an analyst may make before analyzing a set of financial statements is *least* accurate?

A) Cash flow from operations may be affected by the exclusion of off-balance sheet obligations.

B) The income statement should be adjusted to reflect the liability for purchases committed to under a take-or-pay contract.

C) Income statement items that may require adjustment include accounting changes, one-time charges and restructuring charges.

George Edwards is a senior analyst with The Edge Group, an independent equity research firm specializing in micro cap companies that have recently had an initial public offering, or are likely to go public within the next three years. Over the current market cycle, small company stocks have been the leading performers in the equity market, and micro cap money managers have had huge cash inflows due to their funds' strong performance. With an excess amount of cash and few good investment opportunities due to the high valuations in the marketplace, fund managers have turned to independent research firms like The Edge Group to help them discover new investment ideas.

With a large number of mutual fund managers asking them for research reports, business at The Edge Group is booming. To help handle the large amount of business, Edwards has hired two new junior analysts, Paul Kelley and Rachael Schmidt. Both Kelley and Schmidt have degrees in finance, and came highly recommended to Edwards.

In Kelley and Schmidt's orientation meeting, Edwards told them that what has made The Edge Group successful in delivering quality research to its clients is its willingness to dig into company financial statements and not take the accounting numbers at face value. Every item in the financial statements should be scrutinized and adjusted if necessary. Edwards tells the new analysts that if there is one lesson they should learn, it is that "there is a difference between accounting reality and economic reality."

For their first assignment, Edwards has asked the new analysts to put together a draft of a research report on Landesign, an architecture firm specializing in landscape design for municipalities, residential developments, and wealthy individuals. The firm also sells various kinds of stone and plastic products which are used in landscaping applications. Edwards tells the new analysts that he will help put together the report, but he would like them to do a majority of the legwork.

Since it was founded seven years ago, Landesign has grown at an annual rate exceeding 20%. Much of the growth comes from Landesign's acquisitions of regional competitors. Edwards points out to the analysts that Landesign used purchase method accounting. Kelley, looking to impress Edwards with his knowledge, tells him that when one company acquires another, assets of both companies are restated to fair market value, and that higher depreciation can lead to lower quality earnings. Not wanting to be outdone, Schmidt adds that liquidity measures such as the quick ratio and the cash ratio should improve as Landesign makes acquisitions.

Kelley decides to review Landesign's 2004 financial statements and make notes about significant accounting practices being used. His notes are shown in the exhibit below:

Exhibit 1: Kelley's Notes on Landesign's Accounting Practices

- The firm uses First In, First Out (FIFO) accounting. As a side note, the current inflation rate has remained relatively constant at an annual rate of 3%.
- Equipment and office furniture are depreciated based on the 200% declining balance method.
- Fixed assets (equipment) are generally assigned short useful life estimates.
- The expected return on defined benefit pension plan assets is 2 to 3 percentage points below the long-term rate of return for similar assets.
- Landesign reports deferred taxes of $350,000 for 2004, compared with $300,000 and $280,000 in deferred taxes for 2003 and 2002, respectively.

Schmidt notices that the footnotes to Landesign's financial statements include a reference to an agreement to receive a minimum amount of stone used to construct landscape walls from a supplier. Under the terms of the agreement, Landesign will pay for the stone whether it is used in the current accounting period or not. The agreement allows Landesign to pay a price that is significantly less than the current market price for similar quality stone.

A second footnote indicates that Landesign has an eight-year rental commitment for a greenhouse used to grow plants and store mulch that Landesign uses in the landscaping process. On the financial statements, $55,000 in rent expense for the greenhouse is listed on the income statement. The footnote also states that the $55,000 rental expense payment was agreed upon with Fred's Nursery, the owner of the greenhouse, based upon an interest rate of 7%.

A third footnote indicates that Landesign has sold its accounts receivable to Dais Enterprises for 95% of their original value of $130,000. The footnote indicates that Landesign retains the risk of noncollection of the receivables.

The final footnote on the page indicates that Landesign has a revolving line of credit at which it can borrow funds in the future at an interest rate of 6%.

After going through the information, Kelley and Schmidt discuss their findings and start to work on their report for Edwards.

Question #22 of 35

Which of the following items noted in Kelley's Notes on Landesign's Accounting Practices would *least* likely be considered indicators of high earnings quality. Landesign's use of:

A) FIFO accounting in a mildly inflationary economy.

B) the 200% declining balance method of depreciation on its furniture and equipment.

C) short useful life estimates for fixed assets.

Question #23 of 35

Which of the following adjustments should Schmidt make to Landesign's financial statements to account for the greenhouse that Landesign uses to grow plants and store mulch?

A) Increase both liabilities and assets by $328,400.

B) Increase liabilities and decrease equity by $440,000.

C) Increase both liabilities and assets by $341,500.

Question #24 of 35

MKF Consolidated reports $500 million in goodwill on its balance sheet. The market consensus indicates that the value of MKF's intangible assets is $300 million. How should an analyst adjust MKF's balance sheet? Reduce goodwill and:

A) equity by $200 million.

B) increase liabilities by $200 million.

C) equity by $500 million while increasing liabilities by $300 million.

Question #25 of 35

Coastal Drilling Corp (CDC) reported the following year-end data:

EBIT	$23 million
EBT	$20 million
Effective tax rate	40 percent

CDC reported in the footnotes to its financial statements that it had increased the expected return on pension plan assets assumption which resulted in an increase of EBIT of $2 million. Analyst Wanda Brunner, CFA, thinks this change in assumptions is unfounded and removes the $2 million increase in EBIT. Which of the following is *closest* to the tax burden ratio after adjustment?

A) 55.6%.

B) 60.0%.

C) 61.9%.

Question #26 of 35

An analyst is developing a framework for financial statement analysis for his firm. The primary goal of financial statement analysis is to:

A) facilitate an economic decision.

B) document portfolio changes for purposes of the Prudent Investor Rule.

C) justify trading decisions for purposes of the Statement of Code and Standards.

Question #27 of 35

Inventories are listed on the balance sheet at $600,000, retained earnings are $1.9 Million. In the notes to financial statements, you find a LIFO reserve of $125,000. Also, the probability of a LIFO liquidation is high. Assuming a tax rate of 36%, what will be the adjusted value of retained earnings?

A) $1,855,000.00

B) $1,820,000.00

C) $1,980,000.00

Question #28 of 35

What does the LIFO reserve measure?

A) The overstatement relative to the current cost of inventory.

B) The results of older inventory flowing to cost of goods sold (COGS).

C) The accumulated difference between the reported inventory balance and the cost of that inventory if first in, first out (FIFO) had been used.

Question #29 of 35

A firm has booked as a sale, the transfer of $100 million in short-term accounts receivable to Public Finance Co., subject to recourse. The notes to the financial statements disclose that as of the end of the fiscal year, $80 million remained uncollected. In order to reflect this on the balance sheet, which of the following adjustments must be made?

A) Decrease retained earnings and increase accounts receivable.

B) Increase accounts receivable and increase current liabilities.

C) Decrease cash and increase accounts receivable.

Question #30 of 35

Northern Bottling (NB) currently shows minimum expected operating lease payments over the next 5 years of $3 million, $2.5 million, $2 million, $2 million, and $1.5 million. The firm's footnotes show a present value of future capital lease payments of $10.55m discounted at a rate of 6.75%. What adjustments would an analyst make to modify the balance sheet of NB to include this off-balance sheet financing? Increase long-term:

A) assets and long-term liabilities by $9.22 million.

B) assets and long-term liabilities by $9.27 million.

C) liabilities by $9.27 million and decrease equity by $9.27 million.

Question #31 of 35

Adjustments for off-balance-sheet items include all but which of the following?

A) Estimating the probable obligation for contingent liabilities.

B) Using the equity method in place of the proportionate consolidation to reflect the investment in affiliates.

C) Capitalizing operating leases, including this amount as an asset and a liability.

Question #32 of 35

An analyst is analyzing TRK Construction (TRK) for possible recommendation to his firm's clients. He wants to use TRK's financial statements to answer such questions as "Is TRK suitable for firm clients?", "Is TRK priced properly relative to peers?", "What is TRK's earnings quality?" The analyst is *most likely* to begin with:

A) a review of his firm’s framework for analysis of financial statements.

B) a DuPont analysis.

C) analysts adjustments to the financial statements.

Question #33 of 35

Endrun Company reported net income of $4.7 million in 1999, and $4.3 million in 2000. In reviewing the annual report an analyst notices that the Endrun took a charge of $2.4 million in 1999 for the costs of relocating its main office, and in 2000 booked a gain of $900,000 on the sale of its previous office building. What would "normalized earnings" be for 1999 and 2000 if we assume a tax rate of 36% for both years?

A) $7.1 million and $5.2 million.

B) $6.236 million and $3.724 million.

C) $3.99 million and $2.54 million.

Question #34 of 35

Express Delivery Inc. (EDI) reported the following year-end data:

Depreciation expense	$30 million
Net income	$30 million
Total assets	$535 million
Shareholder's equity	$150 million
Effective tax rate	35 percent

Last year EDI purchased a fleet of delivery vehicles for $140 million. For the first year, straight-line depreciation was used assuming a depreciable life of 7 years with no salvage value. However, at year-end EDI's management determined that assumptions of a useful life of 5 years with a salvage value of 10 percent of the original value were more appropriate. How would the return on assets (ROA) and return on equity (ROE) for last year change due to the change in depreciation assumptions? ROA and ROE would be *closest* to:

A) ROA 5.7% and ROE 19.5%.

B) ROA 5.3% and ROE 20.5%.

C) ROA 5.0% and ROE 18.2%.

Question #35 of 35

A firm seeking to lower current tax liability may elect to use which method of inventory valuation during an inflationary period?

A) FIFO.

B) Average cost.

C) LIFO.