Chapter 01

Overview of Financial Statement Analysis

**Multiple Choice Questions**

|  |  |  |  |  |  |  |  |  |  |
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| 1. | Which of the following is likely to be the most informative source if you were interested in a company's business plan or strategy?

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| --- | --- |
| A.  | Auditor's letter |

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| --- | --- |
| B.  | Management discussion and analysis |

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| --- | --- |
| C.  | Proxy statement |

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| --- | --- |
| D.  | Footnotes |

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| 2. | Which of the following would not be considered a source of financing?

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| A.  | Notes receivable |

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| --- | --- |
| B.  | Common stockholders' equity |

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| --- | --- |
| C.  | Retained earnings |

|  |  |
| --- | --- |
| D.  | Debentures |

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| 3. | Wilco Company reports the following:  Dividend payout ratio for 2005 was:

|  |  |
| --- | --- |
| A.  | 27%. |

|  |  |
| --- | --- |
| B.  | 12%. |

|  |  |
| --- | --- |
| C.  | 22.2%. |

|  |  |
| --- | --- |
| D.  | Not determinable |

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| 4. | If a company receives an unqualified audit opinion it means the auditors:

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| --- | --- |
| A.  | did not complete a full audit and therefore do not feel qualified to give an opinion on financial statements. |

|  |  |
| --- | --- |
| B.  | are providing assurance that the company will remain financially viable for at least the next year. |

|  |  |
| --- | --- |
| C.  | are providing assurance that the company's financial statements fairly present company's financial performance and position. |

|  |  |
| --- | --- |
| D.  | are providing assurance that the company's financial statements are free from misstatement, fraudulent accounting and fairly indicate future performance. |

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| 5. | The Management Discussion and Analysis Section of an annual report:

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| A.  | is required by the SEC. |

|  |  |
| --- | --- |
| B.  | is optional but normally included in the annual report. |

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| --- | --- |
| C.  | is required by the SEC only if the company has suffered from unfavorable trends or there are significant uncertainty concerning liquidity of the company. |

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| D.  | is required by the SEC only if they have a qualified audit opinion. |

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|  | You are analyzing a large stable company. For the year ending 12/31/05 the company reported earnings of $58,900 and book value at the end of 2005 was $371,700. You expect earnings to grow at 5% a year in perpetuity, and the dividend payout ratio of 70% to continue. The company borrows at 8%, and has a cost of equity of 12%. The company has 25,000 shares outstanding. |

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| 6. | What is your estimate of price per share using the dividend discount model at 12/31/05?

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| --- | --- |
| A.  | $20.62 |

|  |  |
| --- | --- |
| B.  | $21.65 |

|  |  |
| --- | --- |
| C.  | $23.56 |

|  |  |
| --- | --- |
| D.  | $24.74 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 7. | What is your estimate of price using the residual income valuation model at 12/31/05?

|  |  |
| --- | --- |
| A.  | $20.62 |

|  |  |
| --- | --- |
| B.  | $21.65 |

|  |  |
| --- | --- |
| C.  | $23.56 |

|  |  |
| --- | --- |
| D.  | $24.72 |

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| 8. | Which of the following is *not* a common tool used in financial statement analysis?

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| A.  | Random walk analysis |

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| B.  | Ratio analysis |

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| --- | --- |
| C.  | Common-size statement analysis |

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| --- | --- |
| D.  | Credit analysis |

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| 9. | A common-size income statement would typically be prepared by dividing:

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| --- | --- |
| A.  | all items on income statement in Year *t* by their corresponding value in Year *t-1.* |

|  |  |
| --- | --- |
| B.  | all items on income statement in Year *t* by their corresponding balance sheet accounts in Year *t.* |

|  |  |
| --- | --- |
| C.  | all items on income statement in Year *t* by net income in Year *t-1.* |

|  |  |
| --- | --- |
| D.  | all items on income statement in Year *t* by sales in Year *t.* |

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| 10. | When conducting comparative analysis by reviewing consecutive balance sheets:

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| --- | --- |
| A.  | all items on the balance sheet in Year *t* must be divided by their corresponding value in Year *t-1* and subtract 1 to calculate the percentage change. |

|  |  |
| --- | --- |
| B.  | all items on the balance sheet in Year *t-1* must be subtracted from their corresponding value in Year *t* to calculate the dollar change*.* |

|  |  |
| --- | --- |
| C.  | all items on the balance sheet in Year *t* must be divided by net income in Year *t-1* to calculate the percentage change. |

|  |  |
| --- | --- |
| D.  | Both A and B are correct. |

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| --- | --- |
|  | You have prepared a trend series for Company XYZ for three years, 2004-2006 inclusive, using 2004 as the base year. Below are selected data.   |

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| 11. | From the above information, you can infer that:

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| --- | --- |
| A.  | rate of sales growth has decreased. |

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| --- | --- |
| B.  | net income to sales (return on sales) is increasing over time. |

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| --- | --- |
| C.  | asset turnover is decreasing over time. |

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| --- | --- |
| D.  | None of the above |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 12. | Which of the following statements is *incorrect*?

|  |  |
| --- | --- |
| A.  | Net income in 2006 increased by 29.29% compared to 2004. |

|  |  |
| --- | --- |
| B.  | XYZ's net income to sales (return on sales) is higher in 2006 as compared to 2004. |

|  |  |
| --- | --- |
| C.  | XYZ's net income to sales (return on sales) is lower in 2005 as compared to 2004. |

|  |  |
| --- | --- |
| D.  | Assets have increased over time. |

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Part of the demonstration, if you need more samples, please contact the customer service

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