Assessment

Financial Analysis

Revised Edition

The objectives of this book are:

- To provide a quick review of the basics of financial analysis
- To introduce you to the contents of corporate financial statements
- To provide information about special statements such as inventory, depreciation, and retained earnings
- To discuss ratios concerning capitalization by common stock
- To show various ways that ratios interact when one is changed
- To show how to use quick decision-making techniques
- To provide tips on how to interpret an annual report

CRISP series

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Assessment Questions for
Financial Analysis, Revised Edition

Select the best response.

1. The shareholder's equity is the difference between:
   - A. Profit and loss
   - B. Assets and liabilities
   - C. Sales and expenses
   - D. Earnings and cost of goods

2. A high current ratio may indicate:
   - A. A lack of capital to pay off debt
   - B. The quality of inventory
   - C. That cash is not being put to the best use
   - D. All of the above

3. The net profit ratio:
   - A. Filters out the effects of debt and taxes
   - B. Is not good if it is low
   - C. Measures the effectiveness of management
   - D. All of the above
   - E. A and C

4. A high efficiency ratio may show that:
   - A. Your working capital is high
   - B. Your credit policy is not working well
   - C. Too much money is tied up in goods
   - D. Sales are slow

5. Accounts receivable are:
   A. Monies collected for products or services
   B. Monies owed to the company, but not yet collected
   C. The amount left after paying all bills
   D. The beginning inventory minus the ending inventory

6. Liabilities:
   A. Are on the left side of the balance sheet
   B. Include those things the company owns
   C. That must be paid first appear at the top of the balance sheet
   D. All of the above

7. Select the items that should go on the left side of the balance sheet:
   A. Work in progress and goods in transit
   B. Paid-in capital
   C. Accounts receivable
   D. All of the above
   E. A and C

8. Cash flows out when there is an *increase* in a liability and/or a *decrease* in an asset.
   A. True
   B. False

9. The inventory method that reflects the most recent cost of inventory on the balance sheet is:
   A. Last-in-first-out
   B. First-in-first-out
   C. The average cost method

10. Depreciation:
    A. On the income statement is an expense
    B. Allocates costs over several accounting periods
    C. Does not affect taxes
    D. All of the above
    E. A and B

11. If a fixed asset is more valuable in its first years than in its last, depreciation should be by the:
    A. Straight-line method
    B. Double declining balance method
    C. Sum-of-the-years' digits method
    D. A or C
    E. B or C

12. Capital stock ratios are:
    A. Return on equity
    B. The price-earnings ratio
    C. The capitalization rate
    D. Earnings per share
    E. All of the above

13. To evaluate a company's financial safety, you should use the:
    A. Debt coverage ratios
    B. Earnings per share ratio
    C. Price/earnings ratio
    D. Capitalization rate
    E. Return on equity ratio

14. To measure investors' belief in a company's growth potential, you should use the:
    A. Return on equity ratio
    B. Earnings per share ratio
    C. Price/earnings ratio
    D. Capitalization rate
    E. Debt coverage ratio

15. To measure management's success in achieving profits for the owners, you should use the:
    A. Return on equity ratio
    B. Earnings per share ratio
    C. Price/earnings ratio
    D. Capitalization rate
    E. Debt coverage ratio

16. Ratios are more useful for small, focused companies than large, diverse corporations.
    A. True
    B. False

17. If one of a company's ratios should change:
    A. The others probably will not be affected
    B. It may simply be in the normal course of business
    C. You should consider its effect on the business as a whole
    D. All of the above
    E. B and C

18. The return on investment ratio may be increased by increasing:
    A. Sales
    B. Expenses
    C. Shareholders' equity
    D. All of the above

19. Shareholders' equity can be reduced by:
    A. Increasing liabilities
    B. Reducing retained earnings
    C. Decreasing assets
    D. All of the above
    E. A and C

20. To test the feasibility of a new product before going into production, the best tool is:
    A. Cost-benefit analysis
    B. Decision-tree analysis
    C. Break-even analysis
    D. Leverage

21. Operating leverage results when:
    A. Fixed costs are not covered.
    B. A small change in sales results in a larger change in income
    C. A and B
    D. None of the above

22. Break-even analysis does not permit proper examination of cash flow.
    - A. True
    - B. False

23. Decision-tree analysis involves estimating the:
    - A. Cost
    - B. Income
    - C. Demand
    - D. All of the above
    - E. A and B

24. Potential investors, creditors, and vendors will want to know a company’s:
    - A. Debt situation
    - B. Yearly 10-K statement if the company is publicly owned
    - C. History of collecting its receivables
    - D. All of the above
    - E. A and C

25. To read an annual report, you should look first at the:
    - A. Independent auditor’s report
    - B. Financial statements
    - C. CEO’s letter
    - D. Explanations by the company
    - E. Footnotes

Answer Key for
Financial Analysis, Revised Edition

Recommended response (Corresponding workbook page)

1. B (4)	6. C (22)	11. E (51)	16. A (66)	21. B (87)
2. C (10)	7. E (21)	12. E (58)	17. E (71)	22. A (91)
3. D (11)	8. B (30)	13. A (65)	18. A (72)	23. D (93)
4. B (13)	9. B (47)	14. C (62)	19. D (72)	24. D (103)
5. B (5)	10. E (50)	15. B (61)	20. C (82)	25. A (104)