A- Multiple Choice Questions (40 %)

1. Broomall Corporation has decided to include certain financial ratios in its year-end annual report to shareholders. Selected information relating to its most recent fiscal year is provided below.

• Cash	$10,000
• Accounts receivable	20,000
• Prepaid expenses	8,000
• Inventory	30,000
• Available-for-sale securities	
-At cost	9,000
-Fair value at year end	12,000
• Accounts payable	15,000
• Notes payable (due in 90 days)	25,000
• Bonds payable (due in 10 years)	35,000
• Net credit sales for year	220,000
• Cost of goods sold	140,000

Broomall's working capital at year end is:

a. $40,000.
b. $37,000.
c. $28,000.
d. $10,000.

2. All of the following are affected when merchandise is purchased on credit except

a. total current assets.
b. net working capital.
c. total current liabilities.
d. current ratio.

3. Shown below are beginning and ending balances for certain of Grimaldi Inc.'s accounts.

	January 1	December 31
Cash	$ 48,000	$ 62,000
Marketable securities	42,000	35,000
Accounts receivable	68,000	47,000
Inventory	125,000	138,000
Plant & equipment	325,000	424,000
Accounts payable	32,000	84,000
Accrued liabilities	14,000	11,000
7% bonds payable	95,000	77,000

Grimaldi's acid test ratio or quick ratio at the end of the year is:

a. 0.83.
b. 1.02.
c. 1.15.
d. 1.52.

4. A summary of the Income Statement of Sahara Company is shown below.

Sales	$15,000,000
Cost of sales	9,000,000
Operating expenses	3,000,000
Interest expense	800,000
Taxes	880,000
Net income	$ 1,320,000

Based on the above information, Sahara's degree of financial leverage is

a. 0.96.
b. 1.36.
c. 1.61.
d. 2.27.

5. The following information has been derived from the financial statements of Boutwell Company.

Current assets	$640,000
Total assets	990,000
Long-term liabilities	130,000
Current ratio	3.2 Times

The company's debt-to-equity ratio is

a. 0.50 to 1.
b. 0.37 to 1.
c. 0.33 to 1.
d. 0.13 to 1.

6. Lowell Corporation has decided to include certain financial ratios in its year-end annual report to shareholders. Selected information relating to its most recent fiscal year is provided below.

• Cash	$ 10,000
• Accounts receivable (end of year)	20,000
• Accounts receivable (beginning of year)	24,000
• Inventory (end of year)	30,000
• Inventory (beginning of year)	26,000
• Notes payable (due in 90 days)	25,000
• Bonds payable (due in 10 years)	35,000
• Net credit sales for year	220,000
• Cost of goods sold	140,000

Using a 365-day year, compute Lowell's accounts receivable turnover in days.

a. 26.1 days.
b. 33.2 days.
c. 36.5 days.
d. 39.8 days.

7. Peggy Monahan, controller, has gathered the following information regarding Lampasso Company.

	Beginning of the year	End of the year
Inventory	$6,400	$7,600
Accounts receivable	2,140	3,060
Accounts payable	3,320	3,680

Total sales for the year were $85,900, of which $62,400 were credit sales. The cost of goods sold was $24,500.

Lampasso's inventory turnover ratio for the year was

a. 3.2 times.
b. 3.5 times.
c. 8.2 times.
d. 8.9 times.

8. The assets of Moreland Corporation are presented below.

	January 1	December 31
Cash	$ 48,000	$ 62,000
Marketable securities	42,000	35,000
Accounts receivable	68,000	47,000
Inventory	125,000	138,000
Plant & equipment (net of accumulated depreciation)	325,000	424,000

For the year just ended, Moreland had net income of $96,000 on $900,000 of sales. Moreland's total asset turnover ratio is:

a. 1.27.
b. 1.37.
c. 1.48.
d. 1.50.

9. At the beginning of the year, Lewis Corporation had 100,000 shares of common stock outstanding. During the year, the following transactions occurred.

Date	Transaction
April 1	Issued 10,000 shares in exchange for land
July 1	Declared and distributed a 10% stock dividend
October 1	Purchased 5,000 shares of treasury stock

The number of shares (WACSO) that Lewis should use when computing earnings per share at the end of the year is

a. 117,000.
b. 116,000.
c. 111,750.
d. 106,250.

10. Mayson Company reported net income of $350,000 for last year. The company had 100,000 shares of $10 par value common stock outstanding and 5,000 shares of common stock in treasury during the year. Mayson declared and paid $1 per share dividends on common stock. The market price per common share at the end of last year was $30. The company's dividend yield for the year was:

a. 30.03%.
b. 28.57%.
c. 11.11%.
d. 3.33%.

11. The functional currency of an entity is defined as the currency

a. of the entity's parent company.
b. of the primary country in which the entity is physically located.
c. in which the books of record are maintained for all entity operations.
d. of the primary economic environment in which the entity operates.

12. All of the following are characteristics of preferred stock EXCEPT that

a. it may be callable at the option of the corporation.
b. it may be converted into common stock.
c. its dividends are tax deductible to the issuer.
d. it usually has no voting rights.

13. Foster Manufacturing is analyzing a capital investment project that is forecasted to produce the following cash flows and net income.

Year	After-Tax Cash flow	Net Income
0	($20,000)	$ 0
1	6,000	2,000
2	6,000	2,000
3	8,000	2,000
4	8,000	2,000

The payback period of this project will be

a. 2.5 years.
b. 2.6 years.
c. 3.0 years.
d. 3.3 years.

14. In a management decision process, the cost measurement of the benefits sacrificed due to selecting an alternative use of resources is MOST often referred to as a(n)

a. relevant cost.
b. sunk cost.
c. opportunity cost.
d. differential cost.

15. If the U.S. dollar appreciated against the British pound, other things being equal, we would expect that

a. the British demand for U.S. products would increase.
b. U.S. demand for British products would decrease.
c. U.S. demand for British products would increase.
d. trade between the U.S. and Britain would decrease.

16. Thomas Company's capital structure consists of 30% long-term debt, 25% preferred stock, and 45% common equity. The cost of capital for each component is shown below.

Long-term debt	8%
Preferred stock	11%
Common equity	15%

If Thomas pays taxes at the rate of 40%, what is the company's after-tax weighted average cost of capital?

a. 7.14%.
b. 9.84%.
c. 10.94%.
d. 11.90%.

17. Which one of the following is NOT explicitly considered in the standard calculation of Economic Order Quantity (EOQ)?

a. Level of sales.
b. Fixed ordering costs.
c. Carrying costs.
d. Quantity discounts.

18. If Dexter Industries has a beta value of 1.0, then its

a. return should equal the risk-free rate.
b. price is relatively stable.
c. expected return should approximate the overall market.
d. volatility is low.

19. Carson Inc. manufactures only one product and is preparing its budget for next year based on the following information.

Selling price per unit	$ 100
Variable costs per unit	75
Fixed costs	250,000
Effective tax rate	35%

If Carson wants to achieve a net income of $1.3 million next year, its sales must be

a. 62,000 units.
b. 70,200 units.
c. 80,000 units.
d. 90,000 units.

20. Molar Inc. is evaluating three independent projects for the expansion of different product lines. The Finance Department has performed an extensive analysis of each project and the chief financial officer has indicated that there is no capital rationing in effect. Which of the following statements are correct?

I. Reject any project with a payback period which is shorter than the company standard.

II. The project with the highest internal rate of return (IRR) exceeding the hurdle rate (discount rate) should be selected and the others rejected.

III. All projects with positive net present values should be selected.

IV. Molar should reject any projects with negative IRRs.

a. I, II and IV only.
b. I, II, III and IV.
c. II and III only.
d. III and IV only.

B- <u>Problem Solving</u>

<u>Problem # 1 (18 %)</u>

Wembley Travel Agency specializes in flights between Los Angeles and London. It books passengers on United Airlines at $900 per round trip ticket. Until last month, United paid Wembley a commission of 10% of the ticket price paid by each passenger. This commission was Wembley's only source of revenues. Wembley's fixed costs are $14,000 per month (for salaries, rent, and so on), and its variable costs, such as sales commissions and bonuses, are $20 per ticket purchased for a passenger.

United Airlines has just announced a revised payment schedule for all travel agents. It will now pay travel agents a 10% commission per ticket up to a maximum of $50. Any ticket costing more than $500 generates only $50 commission, regardless of the ticket price. Wembley's managers are concerned about how United's new payment schedule will affect its breakeven point and profitability.

Required:

1. Under the old 10% commission structure, how many round-trip tickets must Wembley sell each month to:

a. break even

b. earn an operating income of $7,000?

2. How does United's revised payment schedule affect your answers to (a) and (b) in requirement 1?

Problem #2 (15%)

The following data are given for the SILVER Company:

Initial cost of proposed equipment	\$75,000
Estimated useful life	7 years
Estimated annual savings in cash operating expenses	\$18,000
Predicted residual value at the end of useful life	\$3,000
Cost of capital	12%

Required:

a. Compute the payback period.

b. Compute the total present value of estimated annual savings.

c. Compute the total present value of estimated residual value.

d. Compute the total present value of estimated cash inflows.

e. Compute the net present value (NPV).

Present Value of \$1: $PVIF_{i,n}$										
Period	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
7	.5132	.4523	.3996	.3759	.3538	.3139	.2791	.2218	.1776	.1432

Present Value of an annuity of \$1: $PVIF_{i,n}$										
Period	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
7	4.8684	4.5638	4.2883	4.1604	4.0386	3.8115	3.6046	3.2423	2.9370	2.6775

Problem #3 (16 %)

Selected data from the Tatum Company are presented below:

Total assets	\$1,500,000
Average assets	1,700,000
Net income	275,000
Net sales	1,400,000
Average stockholders' equity	1,000,000
Net cash provided by operating activities	275,000

Calculate:

- Net Profit margin
- Total Asset turnover
- Return on assets
- Return on stockholders' equity

Problem #4 (11 %)

Three investors are considering investing in a project. Investor A is Risk Averse, investor B is Risk Neutral, and investor C is Risk Taker.

The project is considered to have above average risk return trade-off with respect to similar investments.

a. Briefly define the difference between a risk averse, Neutral risk and risk taker investor.
b. What is the relationship between risk appetite and return in any given investment?
c. Which investor would most probably invest in this project? Justify your answer.

_________________________________ ***GOOD WORK!***