Question 1 of 53

Bosley Corp. has the following selected results for the past two years:

	20X2	20X1
Sales	$503,290	$474,800
Cost of Goods Sold	$278,050	$257,450

During this period, inflation had an 8% growth rate. What is Bosley's gross profit margin percentage for Years 20X2 and 20X1, respectively, and what do these financial results indicate about Bosley's profitability?

A. 44.8%, 45.8%, Bosley Corp.'s gross profit margin is decreasing due to costs rising faster than revenues. ✓

B. 45.8%, 44.8%, Bosley Corp.'s gross profit margin is increasing due to costs rising more slowly than revenues.

C. 55.2%, 54.2%, Bosley Corp.'s gross profit margin is increasing due to costs rising more slowly than revenues.

D. 44.8%, 55.2%, Bosley Corp.'s gross profit margin is decreasing due to costs rising faster than revenues.

Explanation:

(Choice A)

This answer is correct. The gross profit margin percentage (GM%) = (Sales − Cost of goods sold) ÷ Sales.

20X2 GM% = ($503,290 − $278,050) ÷ $503,290 = 44.8%

20X1 GM% = ($474,800 − $257,450) ÷ $474,800 = 45.8%

Sales increase in Year 20X2 = $503,290 − $474,800 = $28,490 ÷ $474,800 = 6%.

Cost of goods sold increase in Year 20X2 = $278,050 − $257,450 = $20,600 ÷ $257,450 = 8%.

Therefore, cost of goods sold is keeping pace with the inflationary rate, while sales prices are growing more slowly, which will cause the gross profit margin and gross profit margin percentage to decrease.

(Choice B) This answer is incorrect. The gross margin percentages are for 20X1 and 20X2, respectively.

(Choice C) This answer is incorrect. The percentages are for cost of goods sold, not the gross profit margin.

(Choice D) This answer is incorrect. The percentages are for 20X2 gross profit margin and cost of goods sold.

Question 2 of 53

An analyst performs a horizontal analysis on Acme Manufacturing and Processing Company's past financial data. The results are presented as shown (all amounts in millions):

	Year 1	Year 2	Year 3	Year 4
Sales revenue	$208	$218	$232	$238
Net income	$160	$168	$172	$176

If Year 1 is the base year, what is the percentage increase in sales revenue from Year 1 to Year 3 (round your answer to the nearest whole percentage)?

A. 10%

B. 8%

C. 7%

D. 12% ✓

Explanation:

(Choice A) 10% is the result if the increase in revenue from Year 1 to Year 3 is divided by Year 3 revenue, not Year 1 revenue. Therefore, this is an incorrect answer.

(Choice B) 8% is the percentage increase in net income from Year 1 to Year 3, not the increase in revenue. Therefore, this is an incorrect answer.

(Choice C) 7% is the result if the increase in net income from Year 1 to Year 3 is divided by Year 3 net income, not Year 1 net income. Therefore, this is an incorrect answer.

(Choice D) The percentage increase is calculated as (Year 3 − Year 1) ÷ Year 1. The figures are ($232 − $208) ÷ $208. The result is 12%. Therefore, this is the correct answer.

Question 3 of 53

If the consumer price index is 135 and was 122 a year ago, the rate of inflation was:

A. 9.6%.

B. −9.6%.

C. 10.7%. ✓

D. −10.7%.

Explanation:

(Choice A) The formula to calculate inflation is (Year 2 – Year 1) ÷ Year 1, instead of (Year 2 – Year 1) ÷ Year 2.

(Choice B) The formula to calculate inflation is (Year 2 – Year 1) ÷ Year 1, instead of (Year 1 – Year 2) ÷ Year 2.

(Choice C) The formula to calculate inflation is (Year 2 – Year 1) ÷ Year 1. (135 – 122) ÷ 122 = 10.7%.

(Choice D) The formula to calculate inflation is (Year 2 – Year 1) ÷ Year 1, instead of (Year 1 – Year 2) ÷ Year 1.

Question 4 of 53

Which of the following financial ratios is most likely to be distorted by inflation?

A. Gross profit ratio

B. Current ratio

C. Return on assets ✓

D. Accounts receivable turnover

Explanation:

(Choice A) This answer is incorrect. Sales revenue and cost of sales are likely to be similarly impacted by inflation.

(Choice B) This answer is incorrect. Current assets and current liabilities are likely to be similarly impacted by inflation.

(Choice C) Correct. Inflation can distort financial information as values can increase because of higher prices and not because more units are purchased or sold. This can possibly lead to distorted financial ratios. The key is whether the numerator and denominator of the ratio are similarly impacted by inflation. If they are similarly impacted, the impact will be small. If not, the impact will be more significant. The numerator of return on assets (net income) will likely be significantly impacted by inflation. However, the denominator (average total assets) will not be significantly impacted. Therefore, return on assets will likely be overstated when inflation is high.

(Choice D) This answer is incorrect. Credit sales and accounts receivable are likely to be similarly impacted by inflation.

Question 5 of 53

An analyst performs a horizontal analysis on Acme Manufacturing and Processing Company's past financial data. The results are presented as shown (all amounts in millions).

	Year 1	Year 2	Year 3	Year 4
Sales revenue	$208	$218	$232	$238
Net income	$160	$168	$172	$176

If Year 2 is the base year, what is the percentage increase in net income from Year 2 to Year 3 (round your answer to the nearest whole percentage)?

A. 6%

B. 4%

C. 3%

D. 2% ✓

Explanation:

(Choice A) 6% [($232 – $218) ÷ $218] is the percentage increase in sales revenue from Year 2 to Year 3. Therefore, this is an incorrect answer.

(Choice B) The dollar increase in net income from Year 2 to Year 3 is $4 ($172 – $168), not 4%. Therefore, this is an incorrect answer.

(Choice C) 3% [($172 – $168) ÷ $160] is the result if the increase in net income from Year 2 to Year 3 is divided by the Year 1 net income, not the Year 2 net income.

(Choice D) The percentage increase is calculated as (Year 3 − Year 2) ÷ Year 2. The figures are ($172 − $168) ÷ $168. The result is 2%. Therefore, this is the correct answer.