MCQ-15542

Shown below are components of a company's financial statements:

Sales revenue	$ 600,000
Cost of goods sold	300,000
Total assets	2,400,000
Total equity	1,500,000
Net income	120,000

What percentage value would net income be on a common-size financial statement?

Calculator

Time Value Tables

A. 5%

B. 8%

C. 20%

D. 40%

Explanation

Choice "C" is correct. Common-size financial statements are used to compare operating performance for two differently sized entities, especially those in the same industry. This is also known as vertical analysis. This is useful for entities in the same industry and compares which cost items influence profitability as well as profitability itself.

For the common-size income statement, all line items in the income statement are expressed as a percentage of net sales revenue. Percentages are calculated by dividing the income statement line item by the net sales revenue and multiplying by 100. In this case, the calculation is as follows:

($120,000 net income ÷ $600,000 sales revenue) × 100 = 20%.

Choice "A" is incorrect. This percentage is net income divided by total assets. Total assets is not the proper denominator in calculating items on the common-size income statement.

Choice "B" is incorrect. This percentage is net income divided by total equity. Total equity is not the proper denominator in calculating items on the common-size income statement.

Choice "D" is incorrect. This percentage is net income divided by cost of goods sold. Cost of goods sold is not the proper denominator in calculating items on the common-size income statement.

MCQ-13722

When preparing common-size statements, items on the balance sheet are generally stated as a percentage of _____ and items on the income statement are generally stated as a percentage of _____.

Calculator

Time Value Tables

A. total assets; net income

B. total shareholders' equity; net income

C. total shareholders' equity; net sales

D. total assets; net sales

Explanation

Choice "D" is correct. Common-size balance sheets express all assets, liabilities, and equities as a percentage of the balance sheet footing (total assets). Common-size income statements express all sales adjustments, expenses, gains, losses, other revenues, and taxes as a percentage of net sales.

Choice "A" is incorrect. When preparing common-size statements, items on the balance sheet are generally stated as a percentage of total assets. However, items on the income statement are not generally stated as a percentage of net income.

Choice "B" is incorrect. When preparing common-size statements, items on the balance sheet are generally not stated as a percentage of total shareholders' equity. Additionally, items on the income statement are not generally stated as a percentage of net income.

Choice "C" is incorrect. When preparing common-size statements, items on the balance sheet are generally not stated as a percentage of total shareholders' equity. However, items on the income statement are generally stated as a percentage of net sales.

MCQ-12701

A useful analysis to compare a large accounting firm's operating results with a small, local accounting firm is:

Calculator

Time Value Tables

A. Horizontal analysis.

B. Vertical analysis.

C. Growth rate analysis.

D. Sensitivity analysis.

Explanation

Choice "B" is correct. In a vertical analysis, all amounts are expressed as a percentage of a line item in each financial statement in order to determine the relationship between two amounts. Typically, the income statement uses sales as the base so that every common-size ratio is a percentage of sales. The balance sheet generally uses total assets as the base, so every common-size ratio is a percentage of total assets. Vertical analysis converts absolute dollar amounts into relative ratios, making it easier to compare companies that are different sizes.

Comparing a larger firm's sales with that of a smaller firm may be impractical in certain cases. For example, a regional multi-office CPA firm may earn $500,000 in profit on revenues of $4,000,000, while a local CPA firm might earn only $20,000 in profit on revenues of $100,000. Even though the larger firm has more revenue and more profit, the smaller firm is earning a higher percentage of profit on the smaller firm's revenues. That is, the smaller firm earns 20 percent in profit on every dollar of revenue ($20,000 profit ÷ $100,000 revenue) compared to the larger firm, which earns only 12.5 percent in profit on every dollar of revenue ($500,000 profit ÷ $4,000,000 revenue).

Choice "A" is incorrect. Horizontal analysis displays each line item in the financial statements as a percentage of a base year for the same line item. Horizontal analysis allows analysts to evaluate an entity's performance over time.

Choice "C" is incorrect. Growth rate analysis is similar to horizontal analysis because both are used to evaluate an entity's performance over time. The difference in the two is that the growth rate is calculated based on the immediately preceding year whereas horizontal analysis is based upon the earliest year reported.

Choice "D" is incorrect. Sensitivity analysis examines how the changes in one variable affect the outcomes. This is used extensively in differential analysis to make decisions.

MCQ-12703

Sweetwater Corp.'s accountant has been asked to recreate financial statement information that was destroyed when a disgruntled manager deleted files and destroyed paper documents. A partial growth rate analysis of an income statement was recovered:

	Percentage of Base Year			*Growth Rate Analysis Increase (Decrease) From Previous Year*	
	Year 3	*Year 2*	*Year 1*	*Year 3*	*Year 2*
Net sales	?	105.42%		4.82%	?
Cost of goods sold	?	95.74%		3.45%	?
Gross profit	?	99.63%		5.14%	?
Operating expenses	?	110.28%		(12.95%)	?
Income taxes	?	102.12%		3.34%	?
Net income	?	114.18%		?	?

If Year 2 cost of goods sold is $344,644, what is the dollar amount for cost of goods sold in Year 1?

Calculator

Time Value Tables

A. $361,255

B. $359,979

C. $356,534

D. $344,644

Explanation

Choice "B" is correct. Growth rate analysis expresses figures as a percentage of a base year, which is the immediately preceding year. This method of presentation allows users to determine how much growth has occurred each year compared to the prior year.

To calculate the amount of cost of goods sold for Year 1, the dollar amount of $344,644 for Year 2 is divided by the base-year ratio of 95.74 percent as follows: $359,979 = 344,644 ÷ 0.9574.

Choice "A" is incorrect. This amount would be correct if the dollar amount for Year 2 COGS increased by 4.82 percent, which is the amount sales increased from Year 2 to Year 3, calculated as follows: $361,255 = 344,644 × (1 + 0.0482).

Choice "C" is incorrect. This is the amount of COGS for Year 2 increased by the growth rate from Year 2 to Year 3, or 344,644 × (1 + 0.0345) = $356,534.

Choice "D" is incorrect. This would be the correct amount if the base-year ratio for COGS for both Years 1 and 2 were equal. However, the dollar amount for Year 2 COGS is 95.74 percent of the amount for Year 1 COGS.

MCQ-15458

Assume the following sales data for a company:

Year 4	$1,200,000
Year 3	1,020,000
Year 2	840,000
Year 1	600,000

What is the percentage increase in sales from Year 1 to Year 2?

Calculator

Time Value Tables

A. 100%

B. 170%

C. 140%

D. 40%

Explanation

Choice "D" is correct. To determine positive or negative growth from year to year, management should frequently review financial statement accounts. Unlike horizontal analysis where a single base year is used for all calculations, measuring growth rates using annual dollar amounts involves shifting the base year forward by one year.

The growth rate is measured as follows:

$$\text{Growth rate} = \frac{\text{Current year amount} - \text{Prior year amount}}{\text{Prior year amount}} = \frac{\$840,000 - \$600,}{\$600,000}$$

Choice "A" is incorrect. This answer choice incorrectly calculated the growth rate of Year 4 compared to Year 1, which is 100 percent.

Choice "B" is incorrect. This calculation represents a common-size base year analysis from Year 1 to Year 3. The 170 percent represents the growth from Year 1 to Year 3, which is calculated as the Year 3 sales of $1,020,000 divided by Year 1 sales of $600,000. The quotient of 1.7 is then multiplied by 100. This question specifically asked for the percentage increase in sales from Year 1 to Year 2.

Choice "C" is incorrect. This calculation represents a common-size base year analysis from Year 1 to Year 2. The 140 percent represents the growth from Year 1 to Year 2, which is calculated as the Year 2 sales of $840,000 divided by Year 1 sales of $600,000. The quotient of 1.4 is then multiplied by 100. This question specifically asked for the percentage increase in sales from Year 1 to Year 2.

MCQ-15457

The following are statements related to horizontal analysis. Which statement(s) is (are) correct?

I. Horizontal analysis is used to review a company's financial statements over multiple periods.

II. Horizontal analysis is usually depicted as a percentage growth over the same line item in the base year.

III. Horizontal analysis allows financial statement users to easily spot trends and growth patterns.

IV. Horizontal analysis can be manipulated to make the current period look better if specific historical periods of poor performance are chosen as a comparison.

Calculator

Time Value Tables

A. I and II

B. I, II, and III

C. I, II, III, and IV

D. I only

Explanation

Choice "C" is correct. Management can use horizontal analysis (base-year trend analysis) in combination with common-size statements to examine the changes in accounts over time. Horizontal analysis helps focus on account balance increases or decreases in relation to a specific base year in order to identify notable trends. The base year is the earliest year reported, and all successive years are expressed in proportion to that base year amount. This method provides a constant base against which multiple years may be analyzed. Horizontal analysis can be manipulated to make the current period look better if specific historical periods of poor performance are chosen as a comparison.

By definition, all of the statements are correct.

Choice "A" is incorrect. This answer choice excludes accurate statements related to horizontal analysis. Horizontal analysis is helpful to users to spot trends and growth over time. Horizontal analysis can be manipulated to make the current period look better if specific historical periods of poor performance are chosen as a comparison.

Choice "B" is incorrect. This answer choice excludes an accurate statement related to horizontal analysis. Management can be selective by choosing a base year with low performance results for comparison with recent years showing improvement in performance.

Choice "D" is incorrect. This answer choice excludes accurate statements related to horizontal analysis. Horizontal analysis is usually depicted as a percentage growth over the same line item in the base year. Horizontal analysis is helpful to users to spot trends and growth over time. Horizontal analysis can be manipulated to make the current period look better if specific historical periods of poor performance are chosen as a comparison.

MCQ-15452

Paul Barlowe is concerned about the results of operations of the two stores he owns in town. He noticed that sales of Store 2 are higher than those of Store 1, yet its profits are lower as shown in the following table:

	Store 1	*Store 2*
Sales	$154,300	$206,100
Cost of goods sold	60,200	78,900
Gross profit	94,100	127,200
Operating expenses:		
Wages	$ 45,600	$ 72,400
Supplies	12,700	16,800
Rent	6,500	8,500
Insurance	2,000	2,700
Other expenses	7,700	8,300
Net income	$ 19,600	$ 18,500

Using vertical analysis, which of the following statements is correct?

Calculator

Time Value Tables

A. Store 2 has a lower net profit percentage and a lower gross profit percentage compared to Store 1.

B. The higher sales in Store 2 are probably due to more salespersons being employed in the store.

C. The high amount of rent paid in Store 2 must be investigated.

D. Higher cost of goods sold in Store 2 indicates inefficient operations compared to Store 1.

Explanation

Choice "B" is correct. Common-size financial statements, also called vertical analysis, show each item in the financial statements as a percentage of a base account within each statement. In a vertical analysis, all line items in the income statement are commonly expressed as a percentage of net sales revenue, allowing comparison of operating performance between two differently sized entities, or among different years for the same entity.
A vertical analysis can be used to compare the stores as follows:

	Store 1	*Store 2*	*Store 1*	*Store 2*
Sales	$154,300	$206,100	100.00%	100.00%
Cost of goods sold	60,200	78,900	39.01%	38.28%
Gross profit	94,100	127,200	60.99%	61.72%
Operating expenses:				
Wages	$ 45,600	$ 72,400	29.55%	35.13%
Supplies	12,700	16,800	8.23%	8.15%
Rent	6,500	8,500	4.21%	4.12%
Insurance	2,000	2,700	1.30%	1.31%
Other expenses	7,700	8,300	4.99%	4.03%
Net income	$ 19,600	$ 18,500	12.70%	8.98%

The vertical analysis shows that Store 2 is paying a higher percentage of its sales revenue (35.13%) in wages compared to Store 1 (29.55%). Increased sales at Store 2 could be a result of higher benefits and incentives paid to salespersons or a higher number of salespersons employed at the store.

Choice "A" is incorrect. Store 2 has a higher gross profit percentage compared to Store 1 based on the vertical analysis performed, while the net profit margin for Store 2 is lower than Store 1. The answer choice incorrectly indicates the margins are lower for both measures.

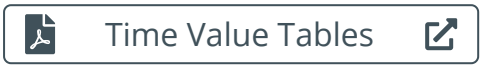
Choice "C" is incorrect. Rent as a percentage of sales for Store 2 (4.12%) is comparable to rent as a percentage of sales for Store 1 (4.21%). This would not trigger an investigation into the rent expense for Store 2.

Choice "D" is incorrect. Cost of goods sold as a percentage of sales is lower for Store 2 than Store 1 at 38.28% and 39.01%, respectively. This would indicate Store 2 is slightly more efficient when compared to Store 1.

MCQ-15455

Which one of the following statements does not represent a benefit of vertical analysis?





A. It is simple to implement and easy to use.

B. It helps identify where management invested its resources.

C. It helps managers compare two different entities of different sizes.

D. It helps managers measure the liquidity of the company.

Explanation

Choice "D" is correct. Common-size financial statements, also called vertical analysis, show each item in the financial statements as a percentage of a base account within each statement. In a vertical analysis, all line items in the income statement are commonly expressed as a percentage of net sales revenue, allowing comparison of operating performance between two differently sized entities in the same industry as well as a comparison among different years for the same entity.

It is easy to implement and can be used to compare different-size entities. This type of analysis shows the composition of total assets by breaking down individual accounts to illustrate concentrations of invested dollars. Vertical analysis is not used to measure liquidity of a company.

Choice "A" is incorrect. This statement indicates a benefit of vertical analysis. Vertical analysis is easy to use and implement.

Choice "B" is incorrect. This statement indicates a benefit of vertical analysis. Vertical analysis shows what percentage of funds has been invested in each type of assets.

Choice "C" is incorrect. This statement indicates a benefit of vertical analysis. Vertical analysis helps a user in comparing entities of different sizes.

MCQ-12880

In assessing the financial prospects for a firm, financial analysts use various techniques. An example of vertical, common-size analysis is:

Calculator

Time Value Tables

A. An assessment of the relative stability of a firm's level of vertical integration.

B. A comparison in financial ratio between two or more firms in the same industry.

C. Advertising expense in 1995 is 2 percent greater than it was in 1994.

D. Advertising expense in 1995 is 2 percent of sales.

Explanation

Choice "D" is correct. Vertical common size analysis is used to determine relationships between different account types in relation to an appropriate base. For example, cash as percentage of total assets, or cost of goods sold as a percentage of total sales revenue.

This type of analysis can be used to create context surrounding compositions of accounts and respective weights or significance of items in relation to the respective base.

A prime example of this would be the evaluation of advertising expense in relation to total sales as a percentage.

Choice "A" is incorrect. The vertical common-size analysis would not be utilized to assess the stability of a firm's level of vertical integration. Vertical integration refers to the company's involvement in all activities associated with acquisition of inventory through the sale and distribution.

Choice "B" is incorrect. The vertical common-size analysis would not be utilized to compare financial ratios between companies within an industry.

Choice "C" is incorrect. The vertical common-size analysis would assist in the analysis of composition of accounts in relation to a base, and while a comparison to previous-year percentages could be evaluated, this would not be categorized as vertical common-size analysis.

MCQ-15459

A financial analyst decided to perform a horizontal analysis on a statement of retained earnings. This type of analysis would not show a percentage change in:

Calculator

Time Value Tables

A. Dividends declared.

B. Net income.

C. Beginning retained earnings.

D. Expenses.

Explanation

Choice "D" is correct. Horizontal analysis helps focus on account balance increases or decreases in relation to a specific base year in order to identify notable trends. The base year is the earliest year reported, and all successive years are expressed in proportion to that base-year amount. This method provides a constant base against which multiple years may be analyzed.

The statement of retained earnings presents the beginning retained earnings balance, net income, and dividends declared to arrive at the ending balance of retained earnings. The statement does not show expenses. Therefore, a horizontal analysis of the statement of retained earnings will not show the change in expenses over time.

Choice "A" is incorrect. Changes in dividends declared are presented when horizontal analysis of the statement of retained earnings is presented.

Choice "B" is incorrect. Changes in net income are presented when horizontal analysis of the statement of retained earnings is presented.

Choice "C" is incorrect. Changes in the beginning retained earnings balances are presented when horizontal analysis of the statement of retained earnings is presented.

MCQ-12702

Sweetwater Corp.'s accountant has been asked to recreate financial statement information that was destroyed when a disgruntled manager deleted files and destroyed paper documents. A partial growth rate analysis of an income statement was recovered:

	Percentage of Base Year			*Growth Rate Analysis Increase (Decrease) From Previous Year*	
	Year 3	*Year 2*	*Year 1*	*Year 3*	*Year 2*
Net sales	?	105.42%		4.82%	?
Cost of goods sold	?	95.74%		3.45%	?
Gross profit	?	99.63%		5.14%	?
Operating expenses	?	110.28%		(12.95%)	?
Income taxes	?	102.12%		3.34%	?
Net income	?	114.18%		?	?

Using growth rate analysis, what is the percentage change in operating expenses for Year 3 over the base year?

Calculator

Time Value Tables

A. 124.56%

B. 96.00%

C. 87.05%

D. 97.63%

Explanation

Choice "B" is correct. Growth rate analysis is used to determine the percentage increase or decrease that occurs due to changes in dollar amounts from the immediately preceding year to the current year. This technique may be used with others to understand the trends that occur over a period of time and that occur from year to year.

To calculate the operating expenses' percentage of the base year for Year 3, the Year 2 percentage of the base year should be multiplied by 1 plus the growth rate from the prior year for Year 3. In this case, it would be 110.28% × (1 + -12.95%) = 96.00%.

Choice "A" is incorrect. This number is the percentage associated with an increase, not a decrease, in the growth rate. If an increase instead of a decease had occurred, the answer would be 124.56% = 110.28% × (1 + 12.95%).

Choice "C" is incorrect. This number is the percentage decrease applied to Year 1, which would yield a 12.95 percent reduction from the base year (100%), or 87.05 percent. Furthermore, growth rates are based on the immediately preceding year, not the earliest year reported.

Choice "D" is incorrect. This percentage is the Year 2 percentage of the base year divided by 1 plus the change from Year 2 to Year 3, or 110.28% ÷ (1 + 0.1295) = 97.64%.

MCQ-15454

A company reported the following comparative information for the first three years of its operations:

	Year 1	Year 2	Year 3
Sales revenue	$69,750	$76,525	$81,275
Cost of sales	43,750	45,625	46,530
Rent expense	5,200	5,300	5,400
Salaries expense	7,000	7,750	9,000
Other expense	4,750	4,850	4,950

Given the above information, which of the following statement(s) is (are) correct?

I. The company is producing its product more efficiently.

II. For each dollar of sales, the company is paying more salaries to its employees in Year 3 compared to Year 1.

III. The company is selling more products every year.

Calculator

Time Value Tables

A. I only

B. I and II

C. II and III

D. I, II, and III

Explanation

Choice "B" is correct. Common-size financial statements, also called vertical analysis, show each item in the financial statements as a percentage of a base account within each statement. In a vertical analysis, all line items in the income statement are commonly expressed as a percentage of net sales revenue, allowing comparison of operating performance between two differently sized entities in the same industry as well as a comparison among different years for the same entity.

Considering the figures given in this fact pattern, the resulting vertical analysis is presented as follows:

	Year 1	*Year 2*	*Year 3*
Sales revenue	100%	100%	100%
Cost of sales	62.72%	59.62%	57.25%
Gross profit	37.28%	40.38%	42.75%
Rent expense	7.46%	6.93%	6.64%
Salaries expense	10.04%	10.13%	11.07%
Other expense	6.81%	6.34%	6.09%
Net income	12.97%	16.99%	18.94%

From the analysis above, cost of sales is decreasing as a percentage of sales revenue each year. This would be an indication of more efficient operations. Additionally, the salaries expense has increased each year over the three-year period provided, indicating higher salaries as a percentage of sales. The statement that the company is selling more products each year cannot be supported based on the information provided in the fact pattern. Sales revenue increases can be the result of volume or price increases.

Choice "A" is incorrect. This answer choice incorrectly excludes the increase in salaries expense in relation to revenue as calculated in the analysis. Even though cost of goods sold is decreasing as a percentage of sales revenue each year and this would be indicative of more efficient operations, salaries expense has also increased from Year 3 to Year 1.

Choice "C" is incorrect. This answer choice incorrectly excludes improved and more efficient operations as evidenced by declining cost of goods sold each year. Further, this answer choice indicates the company is selling at increased volume each year. Although this may be an accurate statement, increased sales revenue could be the result of increased selling prices over the year period as well. This statement assumes the revenue growth is due to volume, and no data in the fact pattern indicates the reason for the growth in revenues.

Choice "D" is incorrect. This answer choice indicates the company is selling at increased volume each year. Although this may be an accurate statement, increased sales revenue could be the result of increased selling prices over the year period as well. This statement assumes the revenue growth is due to volume, and no data in the fact pattern indicates the reason for the growth in revenues.

MCQ-15460

Vertical analysis is a technique that expresses each item within a financial statement:

Calculator

Time Value Tables

A. In dollars and cents.

B. In terms of a percentage of the item in the previous year.

C. In terms of a percent of a base account.

D. Starting with the highest value down to the lowest value.

Explanation

Choice "C" is correct. Common-size financial statements, also called vertical analysis, show each item in the financial statements as a percentage of a base account within each statement. In a vertical analysis, all line items in the income statement are commonly expressed as a percentage of net sales revenue, allowing comparison of operating performance between two differently sized entities in the same industry as well as a comparison among different years for the same entity.

By definition, in a vertical analysis, each item within a financial statement is presented in terms of a percent of a base amount.

Choice "A" is incorrect. In a vertical analysis, each item is presented in terms of a percentage, not an absolute dollar amount.

Choice "B" is incorrect. In vertical analysis, each item is presented in terms of a percentage of a base account within each statement. The horizontal analysis shows each item of the statement as a percentage of the item in the previous year.

Choice "D" is incorrect. In vertical analysis, each item is presented in terms of a percentage of a base account within each statement. Vertical analysis does not rank values from highest to lowest.

MCQ-15456

Horizontal analysis is also called:

Calculator

Time Value Tables

A. Vertical analysis.

B. Base-year trend analysis.

C. Common-size analysis.

D. Straight-line analysis.