

Question #1 of 87

Question ID: 414168

The Widget Company had net income of \$1 million for the period. There were 1 million shares of widget common stock outstanding for the entire period. If there are 100,000 options outstanding with an exercise price of \$40, what is the diluted earnings per share for Widget common stock if the average price per share over the period was \$50?

- ✓ **A) \$0.98.**
- X B) \$0.99.
- X C) \$1.00.

Explanation

Use the Treasury stock method

Proceeds = 100,000 (\$40) = \$4,000,000

Shares assumed purchased with proceeds = \$4,000,000/\$50 = 80,000 shares

Potential dilution = 100,000 - 80,000 = 20,000 shares

Basic EPS = \$1/share

Diluted EPS = \$1,000,000 / 1,020,000 = \$0.98/share

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Question ID: 414060

During 2007, Topeka Corporation entered into the following transactions:

Transaction #1 - Interest on a certificate of deposit owned by Topeka was credited to Topeka's investment account.

Transaction #2 - Topeka sold 10,000 shares of common stock at \$30 that had been repurchased by Topeka last year for \$20.

Should Topeka recognize the results of these transactions as income on the income statement for the year ended December 31, 2007?

- ✓ **A) Only one should be recognized.**
- X B) Both should be recognized.
- X C) Neither should be recognized.

Explanation

Interest earned on the CD is recognized as interest income. The gain on the sale of treasury stock is not reported on the income statement but is selected on the statement of changes in stockholders' equity and on the balance sheet. The sale proceeds simply increase equity and increase cash.

Question #3 of 87

Question ID: 414214

Valuable Corp.'s basic earnings per share (EPS) and diluted EPS for the year are different. Given this information, which of the following statements is *least* accurate?

- ☐ A) Valuable Corp.'s capital structure may include both options and warrants.
- ☒ B) All of Valuable's potentially dilutive securities are antidilutive.
- ☐ C) Diluted EPS is less than basic EPS.

Explanation

If all of Valuable's potentially dilutive securities were antidilutive, then EPS would equal diluted EPS.

Question #4 of 87

Question ID: 414210

All of the following are considered a potentially dilutive securities EXCEPT:

- ☐ A) stock options.
- ☒ B) preferred stock.
- ☐ C) warrants.

Explanation

Not all preferred stock is dilutive. Only *convertible* preferred stock is potentially dilutive.

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Question ID: 414107

Retrospective presentation is *least likely* required for a change from:

- ☐ A) percentage-of-completion to completed contract revenue recognition.
- ☒ B) zero salvage value to positive salvage value.
- ☐ C) LIFO to average cost inventory valuation.

Explanation

Changes in accounting principle require retrospective presentation. A change in the salvage value of an asset is a change in accounting estimate, which does not apply retrospectively.

Question #6 of 87

Question ID: 414206

When calculating earnings per share (EPS) for firms with complex capital structures, convertible preferred stock is ordinarily considered to be a:

- ☐ A) non-equity security.
- ☐ B) antidilutive security.
- ☒ C) potentially dilutive security.

Explanation

Dilutive securities are securities that decrease EPS if they are exercised or converted to common stock. Stock options, warrants, convertible debt, and convertible preferred stock are examples of potentially dilutive securities. Note that if diluted EPS when

considering the convertible preferred stock is greater than basic EPS, the convertible preferred stock would be antidilutive and should not be treated as common stock in computing diluted EPS.

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Question ID: 434271

During 2004, Covax Corp. reported net income of \$2.4 million and 2 million shares of common stock. Covax paid cash dividends of \$14,000 to its preferred shareholders and \$30,000 to its common shareholders. In 2004, Covax issued 900, \$1,000 par, 5.5 percent bonds for \$900,000. Each bond is convertible to 50 shares of common stock. Assume the tax rate is 40%. Compute Covax's basic and diluted EPS.

	<u>Basic EPS</u>	<u>Diluted EPS</u>
✓ A) \$1.19		\$1.18
X B) \$1.22	\$1.22	
X C) \$1.19	\$1.22	

Explanation

2004 Basic EPS:

$$\text{Basic EPS} = \frac{2,400,000 - 14,000}{2,000,000} = \$1.19$$

2004 Diluted EPS:

$$\text{Diluted EPS} = \frac{(2,400,000 - 14,000) + (49,500)(1 - 0.40)}{(2,000,000) + (45,000)} = \$1.18$$

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Question ID: 414150

Which of the following securities would *least likely* be found in a simple capital structure?

- X A) 7%, \$100 par value non convertible preferred.
- ✓ B) 3%, \$100 par value convertible preferred.
- X C) 6%, \$5000 par value putable bond.

Explanation

A simple capital structure contains no potentially dilutive securities such as stock options, warrants, or convertible preferred stock.

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Question ID: 414217

To convert an income statement to a vertical common-size income statement, each line item should be stated as a percentage of:

- X A) net income.
- X B) pretax income.
- ✓ C) revenue.

Explanation

A vertical common-size income statement states each item as a percentage of revenue.

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Question ID: 414092

The Kammel Building Company has a contract to build a building for \$100 million. The estimate of the cost of the project is \$75 million. In the first year of the project, Kammel had costs of \$30 million. Kammel's reported profit for the first year of the contract, using the completed contract method, is:

- ☐ A) \$15 million.
- ☒ B) \$0.
- ☐ C) \$10 million.

Explanation

Under the completed contract method, profit is only reported upon completion of the contract.

Question #11 of 87

Question ID: 414209

Examples of potentially dilutive securities include all of the following EXCEPT:

- ☒ A) non-convertible bonds.
- ☐ B) options.
- ☐ C) convertible preferred stock.

Explanation

Preferred stock and bonds are only considered to be potentially dilutive if they are convertible. Options are always considered to be potentially dilutive.

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Question ID: 414222

A company reports a gain of 100,000 on the sale of an asset and a loss of 100,000 due to foreign currency translation adjustment. Which of these items will be included in the company's comprehensive income?

- ☒ A) Both of these items are included in comprehensive income.
- ☐ B) Neither of these items is included in comprehensive income.
- ☐ C) Only one of these items is included in comprehensive income.

Explanation

Both items are included in comprehensive income. Comprehensive income includes all items that affect owners' equity except transactions with the company's owners. Any items that are included in net income are also included in comprehensive income. The gain on sale is reported in net income. The foreign currency translation loss is taken directly to owners' equity (i.e., not reported in the income statement).

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Question ID: 414142

The SSP Company had 5 million shares outstanding on January 1. On February 15 the board of directors approved a 3:2 stock split, effective April 1. What is the weighted average number of shares outstanding for the SSP Company for year-end?

- ✓ **A) 7,500,000 shares.**
- X **B) 5,625,000 shares.**
- X **C) 6,875,000 shares.**

Explanation

Stock splits and stock dividends are applied to all shares that existed at the beginning of the period and shares that were issued or repurchased during the period, *but prior to the split or dividend*. For SSP, the 5 million beginning-of-year shares outstanding are adjusted to 7.5 million shares ($5.0 \times 3/2$) as a result of the 3:2 split.

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Question ID: 414078

An oil exploration company has been contracted to dig 100 exploratory holes for \$200,000. The cost to complete this job is estimated to be \$150,000, but the company doesn't recognize any of the \$50,000 profit until the job is completed. Which revenue recognition method is being used?

- X **A) Cost recovery method.**
- ✓ **B) Completed contract method.**
- X **C) Percentage-of-completion method.**

Explanation

The completed contract method doesn't recognize revenue and expense until the contract is completed. The percentage-of-completion method would have recognized a portion of the \$50,000 profit prior to completion.

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Question ID: 414133

A simple capital structure is *least likely* to include:

- ✓ **A) convertible bonds.**
- X **B) callable preferred stock.**
- X **C) treasury stock.**

Explanation

Simple capital structures do not include any potentially dilutive securities (a security that could decrease earnings per share if exercised). Convertible bonds are potentially dilutive.

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Question ID: 456300

When a firm recognizes revenue in excess of expenses on a product before cash is collected, what is the impact on the firm's assets and liabilities, ignoring taxes?

	<u>Assets</u>	<u>Liabilities</u>
X A) No effect		Increase
✓ B) Increase		No effect
X C) Increase		Increase

Explanation

When a firm recognizes revenue before cash is collected, equity increases (retained earnings) and assets increase (accounts receivable). Liabilities would not be affected.

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Question ID: 414099

Extraordinary items are:

- X **A) unusual or infrequent.**
- ✓ **B) unusual and infrequent.**
- X **C) reported above the line.**

Explanation

Extraordinary items are unusual *and* infrequent, reported *below* the line separate from income from continuing operations on the income statement, and would include such items as: foreign government confiscation, earthquake damages, losses from volcanic eruptions, etc.

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Question ID: 414124

Washington, Inc.'s stock transactions during the year 20X4 were as follows:

- January 1 720,000 shares issued and outstanding
- May 1 2 for 1 stock split occurred

What was Washington's weighted average number of shares outstanding during 20X4, for earnings per share (EPS) computation purposes?

- X **A) 1,500,000.**
- X **B) 1,666,667.**
- ✓ **C) 1,440,000.**

Explanation

The January 1 balance is adjusted retroactively for the stock split and $(720,000 \times 2 =)$ 1,440,000 shares are treated as outstanding from January.

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Question ID: 414095

In its first year of business, Digmore Corporation's balance sheet shows gross fixed assets at \$90 million and accumulated depreciation of \$10 million. If the estimated salvage value of these assets is \$10 million, and the original estimated useful life is 8 years, what method of depreciation did Digmore *most likely* use?

- ✓ **A) Straight Line.**
- X **B) Units of production.**
- X **C) Double-declining-balance.**

Explanation

\$90 - \$10 million = \$80 million; \$80 million / 8 = \$10 million depreciation per year under Straight Line depreciation.

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Question ID: 414193

Securities that improve basic per share earnings, or reduce per share losses, if they are exercised or converted to common stock are called:

- X **A) embedded securities.**
- X **B) dilutive securities.**
- ✓ **C) antidilutive securities.**

Explanation

Antidilutive securities, upon exercise, increase basic EPS or decrease per share losses. Shares from conversion are not included in the calculation of basic or diluted EPS.

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Question ID: 414119

An analyst gathered the following information about a company:

- 01/01/06 - 20,000 shares issued and outstanding
- 04/01/06 - 5.0% stock dividend
- 07/01/06 - 5,000 shares repurchased
- 10/01/06 - 2:1 stock split

What is the company's weighted average number of shares outstanding at the end of 2006?

- X **A) 47,000.**
- ✓ **B) 37,000.**
- X **C) 39,500.**

Explanation

The end-of-period weighted average number of common shares outstanding is the number of shares outstanding during the year weighted by the portion of the year they were outstanding. Dividends and splits are applied to all shares issued or repurchased and all original or adjusted shares outstanding *prior* to the split or dividend.

Step 1) Apply the 04/01/06 dividend to the beginning of year shares:

Adjusted shares = $1.05 \times 20,000 = 21,000$

Step 2) Apply the 10/01/06 split to the adjusted beginning-of-year shares and the repurchase.

Adjusted beginning-of-year shares = 42,000 ($= 2 \times 21,000$)

Adjusted repurchase = 10,000 ($= 2 \times 5,000$)

Step 3) Compute the weighted average number of shares.

$42,000(12/12) - 10,000(6/12) = 37,000$ shares

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Question ID: 414132

Ajax Company has a simple capital structure. Which of the following will NOT be found on its balance sheet?

- ☐ A) 10%, secured mortgage bond denominated in Swiss francs.
- ☐ B) 6%, \$50 par value callable bond.
- ☒ C) 3%, \$100 par value convertible bond.

Explanation

If convertible bonds exist, the firm has a complex capital structure.

Question #23 of 87

Question ID: 414212

Selected information from Feder Corp.'s financial activities for the year is as follows:

- Net income was \$7,650,000.
- 1,100,000 shares of common stock were outstanding on January 1.
- The average market price per share was \$62.
- Dividends were paid during the year.
- The tax rate was 40%.
- 10,000 shares of 6% \$1,000 par value preferred shares convertible into common shares at a rate of 20 common shares for each preferred share were outstanding for the entire year.
- 70,000 options, which allow the holder to purchase 10 shares of common stock at an exercise price of \$50 per common share, were outstanding the entire year.

Feder Corp.'s diluted earnings per share (EPS) was *closest* to:

- ☐ A) \$4.91.
- ☒ B) \$5.32.
- ☐ C) \$5.87.

Explanation

Feder's basic earnings per share ((net income - preferred dividends) / weighted average shares outstanding) was $((\$7,650,000 - (\$1,000 \times 10,000 \times 0.06)) / 1,100,000 =) \6.41 .

If the convertible preferred stock was converted to common stock at January 1, $(10,000 \times 20 =) 200,000$ additional common

shares would have been issued, dividends on the preferred stock would not have been paid, and Diluted EPS would have been $(\$7,650,000 / (1,100,000 + 200,000)) = \5.88 . Because \$5.88 is less than basic EPS of \$6.41, the preferred shares are dilutive.

Using the treasury stock method, if the options were exercised cash inflow would be $(70,000 \times 10 \times \$50 =) \$35,000,000$. The number of Feder shares that can be purchased with the inflow (cash inflow divided by the average share price) is $(\$35,000,000 / \$62 =) 564,516$.

The number of shares that would have been created is $(700,000 - 564,516 =) 135,484$. Diluted EPS was $(\$7,650,000 / (1,100,000 + 135,484)) = \6.19 . Because this is less than the EPS of \$6.41, the options are dilutive.

Combining the calculations, Diluted EPS was $((\$7,650,000) / (1,100,000 + 200,000 + 135,484)) = \5.32 .

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Question ID: 414064

As a general rule, revenue is normally recognized when it is:

- ☐ A) measurable.
- ☒ B) realizable and earned.
- ☐ C) earned.

Explanation

Under the accrual concept, revenue is recognized when the earnings process is completed (earned) and ultimate realization (cash receipt) is assured.

Question #25 of 87

Question ID: 434277

The Fischer Company had net income of \$1,500,000. Fischer paid preferred dividends of \$5 on each of the 100,000 preferred shares. There are 1 million Fischer common shares outstanding. In addition to the common and preferred stock, Fischer has \$25 million of 4% bonds outstanding. The face value of each bond is \$1,000. Each bond is convertible into 40 common shares. If Fischer's tax rate is 40%, determine its basic and diluted earnings per share (EPS)?

	<u>Basic EPS</u>	<u>Diluted EPS</u>
<input type="radio"/> A) \$1.50		\$1.25
<input checked="" type="radio"/> B) \$1.00		\$0.80
<input type="radio"/> C) \$1.00		\$1.25

Explanation

$$\text{Basic EPS} = \frac{(\$1,500,000 - \$500,000)}{1,000,000} = \$1.00$$

$$\text{Diluted EPS} = \frac{(\$1,500,000 - \$500,000) + \$1,000,000(1 - 0.4)}{1,000,000 + 1,000,000} = \frac{\$1,600,000}{2,000,000} = \$0.80$$

Question #26 of 87

Question ID: 414067

Under the cost recovery method, profit is recognized:

- ☐ **A) at time of delivery.**
- ☐ **B) as collection occurs.**
- ☒ **C) after the amount of cost has been collected.**

Explanation

The cost recovery method is used when the costs to provide goods or services are not known. Under this method, sales are recognized when cash is received, but no gross profit is recognized until all of the cost of goods sold is collected.

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Question ID: 414090

The Better Building Company has a contract to build a building for \$100 million. The estimate of the cost of the project is \$75 million. In the first year of the project, BB had costs of \$30 million. The Better Building Company's reported profit for the first year of the contract, using the percentage-of-completion method, is:

- ☒ **A) \$10 million.**
- ☐ **B) \$0.**
- ☐ **C) \$20 million.**

Explanation

Reported profit (in millions) = $(\$30 / \$75)(\$100 - 75) = \10 .

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Question ID: 414207

When calculating earnings per share (EPS) for firms with complex capital structures, convertible bonds are ordinarily considered to be:

- ☐ **A) embedded debt securities.**
- ☐ **B) antidilutive securities.**
- ☒ **C) potentially dilutive securities.**

Explanation

Dilutive securities are securities that decrease EPS if they are exercised or converted to common stock. Stock options, warrants, convertible debt, and convertible preferred stock are examples of potentially dilutive securities. Note that if diluted EPS when considering the convertible bonds is greater than basic EPS, the convertible bonds would be antidilutive and should not be treated as common stock in computing diluted EPS.

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Question ID: 414079

Which revenue recognition method is used when the payment is assured and revenue is earned as costs are incurred?

- ☐ **A) Installment sales method.**
- ☒ **B) Percentage-of-completion method.**
- ☐ **C) Cost recovery method.**

Explanation

The installment sales method is used when the assurance of payment and estimated bad debts does not exist before cash is collected. Sales revenue and COGS are recognized only when cash is received.

The cost recovery method is used when future cash collections are not assured even after receipt of partial payments. Gross profit is not recognized until all of the cost of goods sold is collected.

Question #30 of 87

Question ID: 414185

Selected information from Baltimore Corp's financial activities in the year 2004 is as follows:

- Net income was \$4,200,000 .
- 750,000 shares of common stock were outstanding on January 1.
- The average market price per share was \$50 in 2004.
- Dividends were paid in 2004.

10,000 warrants, which allowed the holder to purchase 10 shares of common stock for each warrant held at a price of \$40 per common share, were outstanding the entire year.

Baltimore's diluted earnings per share (Diluted EPS) for 2004 is *closest* to:

- ☐ A) \$4.94.
- ☒ B) \$5.45.
- ☐ C) \$5.60.

Explanation

Baltimore's basic earnings per share (EPS) (net income / weighted average shares outstanding) for 2004 was $\$4,200,000 / 750,000 = \5.60 .

To calculate diluted EPS, we use the treasury stock method to account for the warrants:

- Number of common shares created if options are exercised = $10,000 \times 10 = 100,000$
- Cash inflow if warrants are exercised = $\$40 \times 100,000 = \$4,000,000$
- Shares purchased with these funds = $\$4,000,000 / 50 = 80,000$
- Net increase in shares outstanding = $100,000 - 80,000 = 20,000$

Diluted EPS = $\$4,200,000 / (750,000 + 20,000) = \5.45 .

Question #31 of 87

Question ID: 414109

Which of the following items for a financial services company is *least likely* to be considered an operating item on the income statement?

- ☐ A) Interest income.
- ☐ B) Financing expenses.
- ☒ C) Income tax expense.

Explanation

For a financial services company, interest income, interest expense, and financing expenses are likely considered operating activities. For both financial and nonfinancial companies, income tax expense is a non-operating item that is reported within "income from continuing operations" as opposed to "operating profit" as with the other answer choices. Therefore, of the three choices, income tax expense is least likely to be considered an operating item.

Question #32 of 87

Question ID: 414141

A firm has had the following numbers of shares outstanding during the year:

Beginning of year	10,000,000 shares
Issued on April 1	500,000 shares
Split 2 for 1 on July 1	
Issued on October 1	100,000 shares
Split 2 for 1 on December 31	

Based on this information, what is the weighted number of shares outstanding for the year?

- ✓ **A) 41,550,000.**
- X **B) 20,780,000.**
- X **C) 42,400,000.**

Explanation

Outstanding all year	$10,000,000 \times 2 \times 2 \times 1$	40,000,000
Outstanding for 0.75 years	$500,000 \times 2 \times 2 \times 0.75$	1,500,000
Outstanding for 0.25 years	$100,000 \times 2 \times 0.25$	50,000
Weighted average number of shares for year:		41,550,000

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Question ID: 414139

At the beginning of this year Aristotle Co. had 400,000 shares of common stock outstanding. During the year, Aristotle paid a 10 percent stock dividend on May 31, issued 90,000 new common shares on June 30, and repurchased 12,000 shares on December 1. The number of shares Aristotle should use in computing earnings per share at the end of the year is:

- ✓ **A) 484,000.**
- X **B) 476,000.**
- X **C) 475,000.**

Explanation

$[400,000 \text{ shares} \times 12 \text{ months} + 40,000 \times 12 \text{ months} + 90,000 \times 6 \text{ months} - (12,000 \times 1 \text{ months})]$ divided by 12 = 484,000 shares.

Question #34 of 87

Question ID: 414070

Which of the following statements regarding the methods of revenue recognition is *most* accurate? In the first year of a long-term contract:

- ☐ A) the completed contract method, in comparison to the percentage-of-completion method, will generally result in higher net income.
- ☐ B) the percentage-of-completion method generally results in lower retained earnings than the completed contract method.
- ☒ C) the completed contract method is used when the selling price or cost estimates are unreliable.

Explanation

The completed contract method compared to the percentage-of-completion method will result in lower net income in the first year because revenue and profit are recognized later. Hence, retained earnings will also be lower than the percentage-of-completion method.

Question #35 of 87

Question ID: 414221

Matrix, Inc.'s common size income statement for the years ended December 31, 20X1 and 20X2 included the following information (percent of net sales):

	20X1	20X2
Sales	100	100
Cost of Goods Sold	(55)	(60)
		40
Selling General & Administrative	(5)	(5)
Depreciation	(7)	(8)
		33
Interest Expense	(15)	(7)
		18
Income Tax Expense	(6)	(10)
		12
		20

Analysis of this data indicates that from 20X1 to 20X2:

- ☐ A) the effective tax rate increased.
- ☐ B) cost of goods sold increased.
- ☒ C) interest expense per dollar of sales declined.

Explanation

On a common size income statement, all amounts are stated as a percentage of sales. Interest expense per dollar of sales has

declined from 0.15 to 0.07. The other interpretations listed are not necessarily correct. COGS increased as a percentage of sales, but if sales decreased, COGS may have decreased as well. The company's effective tax rate (income tax expense / pretax income) can be calculated from a common-size income statement. Here the effective tax rate was 33% in both years.

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Question ID: 414228

According to the Financial Accounting Standards Board, what is the appropriate balance sheet treatment for available-for-sale securities and where are the unrealized gains and losses reported?

<u>Balance sheet</u>	<u>Unrealized gains and losses</u>
X A) Fair value	Net income
X B) Amortized cost	Other comprehensive income
✓ C) Fair value	Other comprehensive income

Explanation

Available-for-sale securities are reported on the balance sheet at fair value. The unrealized gains and losses bypass the income statement and are reported as a component of stockholders' equity as a part of other comprehensive income.

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Question ID: 414112

Red Oak Corporation is a furniture manufacturer located in Canada. Red Oak is financed with a combination of debt and equity. The debt consists of unsecured zero-coupon bonds that mature in 20 years. For income tax purposes, interest on the bonds is deductible when accrued. Red Oak's equity consists of common stock and preferred stock. No dividends have ever been paid on Red Oak's common stock; however, dividends are paid quarterly to the preferred shareholders. Should the accrued interest on the zero-coupon bonds and the dividends paid to the preferred shareholders be reported as a nonoperating component of Red Oak's net income?

<u>Accrued interest</u>	<u>Preferred dividends</u>
X A) No	Yes
X B) Yes	Yes
✓ C) Yes	No

Explanation

Since Red Oak is a nonfinancial firm, the accrued interest is considered a nonoperating activity, related to how the firm is financed. Dividends paid to preferred shareholders do not affect net income.

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Question ID: 414216

Royster Company presents the following income statement:

Sales	\$12,000
Cost of goods sold	\$6,000
Selling and administrative expense	\$1,200
Interest expense	\$600
Pretax income	\$4,200
Income tax expense	\$1,470
Net income	\$2,730

Which of the following line items would appear on a common-size income statement for this period?

- ✓ **A) Pretax income 35%**
- X **B) Income tax expense 54%**
- X **C) Net income 65%**

Explanation

Common-size income statements express each line item as a percentage of sales.

Sales	100%
Cost of goods sold	50%
Selling and administrative expense	10%
Interest expense	5%
Pretax income	35%
Income tax expense	12.25%
Net income	22.75%

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Question ID: 414111

Pinto Corporation is an automobile manufacturer located in North America. Pinto owns a 5 percent interest in one of its suppliers, Continental Supply Company. Each year, Pinto receives a cash dividend from Continental. Pinto's engine supplier, National Supply Company, recently increased prices on goods sold to all customers due to higher labor costs. Should Pinto report the dividends received from Continental and the price increase from National as an operating or nonoperating component on its year-end income statement?

- X **A) Both are nonoperating.**
- ✓ **B) Only one is operating.**
- X **C) Both are operating.**

Explanation

Since Pinto is a nonfinancial firm, dividends received would be considered a nonoperating component. An increase in cost of goods sold would be considered a part of normal operations.

Question #40 of 87

Question ID: 414220

Selected financial ratios from Mulroy Company's common-size income statements are as follows:

	20X1	20X2	20X3
Gross profit margin	22%	24%	26%
Operating profit margin	18%	20%	22%
Pretax margin	15%	14%	13%
Net profit margin	11%	10%	9%

Relative to sales, it is *most likely* that Mulroy's:

- ✓ **A) nonoperating expenses are increasing.**
- X **B) operating expenses are increasing.**
- X **C) income tax expense is increasing.**

Explanation

Nonoperating expenses are equal to the difference between operating profit and pretax profit. Based on the given profit margins, Mulroy's nonoperating expenses increased from 3% of sales in 20X1 to 9% of sales in 20X3. Because gross profit margin is increasing, cost of goods sold is decreasing as a percentage of sales. Other operating expenses and income tax expense, as a percentage of sales, were stable over the period shown.

Question #41 of 87

Question ID: 414167

The Gaffe Company had net income of \$1,500,000. Gaffe paid preferred dividends of \$5 on each of the 100,000 preferred shares. Each preferred share is convertible into 20 common shares. There are 1 million Gaffe common shares outstanding. In addition to the common and preferred stock, Gaffe has \$25 million of 4% bonds outstanding. If Gaffe's tax rate is 40%, what is its diluted earnings per share?

- X **A) \$1.00.**
- ✓ **B) \$0.50.**
- X **C) \$0.33.**

Explanation

The preferred shares are convertible into $100,000 \times 20 = 2$ million common shares. They are dilutive since:

$$\begin{aligned}\text{Basic EPS} &= \frac{\$1,000,000}{1,000,000} = \$1.00 \\ \text{Diluted EPS} &= \frac{\$1,500,000}{3,000,000} = \$0.50 \text{ which is less.}\end{aligned}$$

Question #42 of 87

Question ID: 414195

Advantage Corp.'s capital structure was as follows:

December 31, 2005 December 31, 2004

Outstanding shares of stock:		
Common	110,000	110,000
Convertible Preferred	10,000	10,000
8% Convertible Bonds	\$1,000,000	\$1,000,000

During 2005, Advantage paid dividends of \$3 per share on its preferred stock. The preferred shares are convertible into 20,000 shares of common stock. The 8% bonds are convertible into 30,000 shares of common stock. Net income for 2005 was \$850,000. Assume the income tax rate is 30%.

Calculate Advantage's basic and diluted earnings per share (EPS) for 2005.

	<u>Basic EPS</u>	<u>Diluted EPS</u>
X A) \$7.45		\$6.26
X B) \$6.31		\$5.66
✓ C) \$7.45		\$5.66

Explanation

Basic EPS = net income – pref div / wt. ave. shares of common

$$[850,000 - (3 \times 10,000)] / 110,000 = \$7.45$$

Diluted EPS = [(net income – preferred dividends) + convertible preferred dividends + (convertible debt interest)(1 – t)] / [(weighted average shares) + (shares from conversion of conv. pfd shares) + (shares from conversion of conv. debt) + (shares issuable from stock options)]

$$[(850,000 - (3 \times 10,000)) + 30,000 + (80,000)(1 - 0.3)] / [(110,000) + (20,000) + (30,000)] = \$5.66.$$

Question #43 of 87

Question ID: 434270

An analyst has gathered the following information about a company:

- 110,000 shares of common outstanding at the beginning of the year.
- The company repurchases 20,000 of its own common shares on July 1.
- Net income is \$300,000 for the year.
- 10,000 shares of existing 10 percent cumulative \$100 par preferred outstanding that is not in arrears at the beginning or ending of the year.
- The company also has \$1 million in 10 percent callable bonds outstanding.
- The company has declared a \$0.50 dividend on the common.

What is the company's basic Earnings Per Share?

- X A) \$1.00.
- X B) \$3.00.
- ✓ C) \$2.00.

Explanation

Interest is already deducted from earnings.

$$\frac{300,000 - (0.10)(\$100)(10,000)}{110,000 - (6/12)(20,000)} = \$2.00$$

Question #44 of 87

Question ID: 414159

When considering convertible preferred stock which of the following components of the earnings per share (EPS) equation needs to be adjusted to calculate diluted earnings per share?

- ☐ A) The numerator.
- ☒ B) The numerator and denominator.
- ☐ C) The denominator.

Explanation

The numerator will increase because earnings available to the common shareholder are increased by the reduction in preferred dividends. The denominator increases because the weighted average number of shares increases upon conversion of the preferred stock.

Question #45 of 87

Question ID: 414151

Sampson Corp. had 500,000 shares of common stock outstanding at the beginning of the year. The average market price was \$20.

- On April 1, Sampson issued 100,000 shares of \$1000 par value 10 percent preferred stock.
- On July 1, Sampson issued 200,000 warrants to purchase 10 shares of common stock each at \$22 per share.
- On October 1, Sampson repurchased 60,000 of common stock as treasury stock for \$15 per share.

The weighted average common shares outstanding Sampson should use to compute basic earnings per share (EPS) was:

- ☐ A) 600,000.
- ☒ B) 485,000.
- ☐ C) 515,000.

Explanation

Only the October 1 transaction affects the weighted average common shares outstanding because the April 1 transaction would not affect the number of shares outstanding and the July 1 transaction involves warrants which would not be included in the basic EPS calculation. The computation for basic EPS is $[(500,000 \times 12) - (60,000 \times 3)] / 12 = 485,000$.

Question #46 of 87

Question ID: 414118

Maine Company's stock transactions during the year are described below:

- January 1 100,000 common shares outstanding
- March 1 2 for 1 stock split
- August 1 10% stock dividend

The weighted average number of shares outstanding used to calculate earnings per share is:

- ☒ A) 220,000.
- ☐ B) 201,666.

X **C)** 211,111.

Explanation

The January 1 balance of common shares outstanding is adjusted retroactively for both stock dividends and stock splits. The weighted average shares outstanding for the year = $100,000 \times 2 \times 1.1 = 220,000$.

Question #47 of 87

Question ID: 414105

Which of the following is *least likely* reported net of tax on the income statement under U.S. GAAP?

- ✓ **A) Interest expense.**
- X **B)** Extraordinary items.
- X **C)** Income from discontinued operations.

Explanation

Interest expense would be considered an expense that is incurred from continuing operations and, therefore, is listed prior to subtracting the income tax expense on the income statement. Income from discontinued operations and extraordinary items are included on the income statement after the net income from continuing operations is reported and after the income tax expense from continuing operations is reported. Therefore, these latter accounts are reported net of tax.

Question #48 of 87

Question ID: 414061

Do gains and losses, as well as expenses appear on the income statement?

- X **A) Only expenses appear on the income statement.**
- ✓ **B)** Both appear on the income statement.
- X **C)** Only gains and losses appear on the income statement.

Explanation

Gains and losses result from transactions that are not a part of the firm's normal business operations. Expenses are amounts that are incurred to generate revenue; thus, expenses result from the firm's ongoing operations. Both are included on the income statement.

Question #49 of 87

Question ID: 414192

Which of the following statements about the earnings per share calculation are *most* accurate?

- X **A) When calculating diluted EPS you must add the shares created from the conversion of the bonds to the denominator and the interest expense times the tax rate to the numerator.**
- X **B)** If the diluted EPS is less than the basic EPS, then the diluted EPS is said to be anti-dilutive.
- ✓ **C)** None of these choices are correct.

Explanation

Anti-dilutive is when dilutive EPS > basic EPS. When calculating diluted EPS, you must add the shares created from the conversion of the

bonds to the denominator and the interest (1 - tax rate) to the numerator.

Question #50 of 87

Question ID: 414094

Which expense recognition method is *most appropriate* for intangible assets with indefinite lives?

- ☐ A) Use accelerated amortization for tax reporting and straight-line amortization for financial reporting.
- ☒ B) Test for impairment but do not amortize.
- ☐ C) Use straight-line amortization.

Explanation

Under IFRS and U.S. GAAP, intangible assets with indefinite lives (e.g., goodwill) are not amortized but are tested for impairment at least annually.

Question #51 of 87

Question ID: 414182

Kendall Company's net income for 20X4 is \$830,000 with 200,000 shares outstanding. Kendall has 1,000 6% convertible bonds (each bond \$1,000 face value and convertible into 20 common shares) outstanding for the entire year. Kendall's tax rate is 40%. What is Kendall Company's diluted earnings per share for 20X4?

- ☐ A) \$3.77.
- ☒ B) \$3.94.
- ☐ C) \$4.15.

Explanation

Kendall's basic EPS is $\$830,000 / 200,000 = \4.15 . To compute diluted EPS, bond interest paid net of taxes is added to net income, and the number of shares that would be issued in the conversion is added to the denominator. Kendall's diluted EPS = $[\$830,000 + (1,000 \times \$1,000 \times 0.06) \times (1 - 0.4)] / (200,000 + 20,000) = \3.94 . Since diluted EPS is less than basic EPS, we know that the bonds are dilutive and should be considered in calculating diluted EPS.

Question #52 of 87

Question ID: 414106

All the following items are reported net of taxes below net income from continuing operations on the income statement EXCEPT:

- ☐ A) extraordinary items.
- ☒ B) unusual or infrequent items.
- ☐ C) expropriations by foreign governments.

Explanation

Unusual or infrequent items appear as a component of net income from continuing operations and are reported "above the line." Extraordinary items, such as expropriations, are unusual and infrequent *and* appear "below the line."

Question #53 of 87

Question ID: 414136

Consider the following information on the past year's operating performance and current capital structure for the following two companies:

<i>Supple Moves</i>	<i>Perfect Collection</i>
Paid no dividends	Paid common & pref. div.
Ave. Stock Price of \$42.00	Ave. Stock Price of \$22.00
Positive net income	Positive net income
110,000 warrants with an exercise price of \$50.00	Convertible debt with an 8.0% coupon, conversion ratio at 10.0.
	150,000 options outstanding with an exercise price of \$19.50

Based on the information above, which of the companies has a complex capital structure?

- ☐ A) **Supple Moves only.**
- ☒ B) Supple Moves and Perfect Collection.
- ☐ C) Perfect Collection only.

Explanation

A complex capital structure is one that has *potentially* dilutive elements. Here, Supple Moves and Perfect Collection both meet this criteria. (The warrants for Supple Moves will be dilutive if the average stock prices were over \$50.00.)

Question #54 of 87

Question ID: 414073

According to the installment method of accounting, gross profit on an installment sale is recognized:

- ☐ A) **on the date the final cash collection is received.**
- ☒ B) in proportion to the cash collection.
- ☐ C) after cash collections equal to the cost of sales have been received.

Explanation

The installment sales method recognizes sales and COGS in proportion to cash collections.

Question #55 of 87

Question ID: 434276

CXW, Inc. has issued 9,986 warrants, which were outstanding for the entire year, with an exercise price of \$38. Each warrant is convertible into 1 share of common. The average market price of CXW's common stock for the year is \$52.00 per share and its price at the end of the year is \$45.00 per share. In the calculation of CXW's diluted earnings per share, how many new shares would theoretically need to be issued to facilitate warrant conversion?

- ☒ A) **2,689.**

X B) 8,433.

X C) 9,986.

Explanation

If the warrants were exercised, the firm would receive the exercise price for each warrant:

$$9,986 \times \$38 = \$379,468$$

Using the treasury stock method, we assume the firm uses this cash to repurchase shares at the average price for the year:

$$\$379,468 / \$52 = 7,297 \text{ common shares}$$

If these repurchased shares were used toward fulfilling the warrants, the firm would need to issue $9,986 - 7,297 = 2,689$ new common shares to fulfill the rest of the warrants.

Question #56 of 87

Question ID: 414153

Savannah Corp.'s financial accounts for the year ended December 31 included the following information:

- Net Income: \$122,000
- Preferred Stock Dividends Paid: \$35,000
- Common Stock Dividends Paid: \$42,000
- Common Shares outstanding at January 1: 50,000
- 10% preferred \$100 par value shares outstanding at January 1: 3,500

No stock transactions occurred during the year and all preferred stock dividends were paid. Basic earnings per share for Savannah are *closest* to:

✓ A) \$1.74.

X B) \$0.90.

X C) \$2.44.

Explanation

Savannah Corp.'s basic EPS ((net income - preferred dividends) / weighted average number of common shares outstanding) was $((\$122,000 - \$35,000) / 50,000 =) \$1.74$.

Question #57 of 87

Question ID: 414147

Jersey, Inc.'s financial information included the following for its year ended December 31:

- 160,000 shares of common stock were outstanding for the entire year.
- 18,000 shares of 10%, \$100 par value cumulative preferred stock were outstanding for the entire year.
- Common stock dividends paid during the current year were \$240,000.
- All preferred stock dividends were paid for the current year.
- Net income was \$720,000.

Basic earnings per share for Jersey, Inc. for the year ended December 31 are *closest to*:

X A) \$2.81.

X B) \$4.50.

✓ **C) \$3.38.**

Explanation

Jersey, Inc.'s basic EPS = (net income - preferred dividends) / (weighted average number of common shares outstanding) was $(\$720,000 - \$180,000)/160,000 = \$3.38$.

Question #58 of 87

Question ID: 414171

Ajax Company's capital structure was as follows:

	<i>December 31, 2004</i>	<i>December 31, 2003</i>
<i>Outstanding shares of stock:</i>		
<i>Common</i>	200,000	200,000
<i>Convertible preferred</i>	5,000	5,000
<i>6% Convertible Bonds</i>	\$500,000	\$500,000

- During 2004, Ajax paid dividends of \$2.00 per share on its preferred stock.
- The preferred shares are convertible into 10,000 shares of common stock.
- The 6% bonds are convertible into 15,000 shares of common stock.
- Net income for 2004 was \$400,000.
- Assume that income tax rate is 40%.

Ajax's basic and diluted earnings per share for 2004 are:

	<u>Basic EPS</u>	<u>Diluted EPS</u>
X A) \$1.80	\$1.86	
✓ B) \$1.95	\$1.86	
X C) \$1.95	\$1.95	

Explanation

Basic EPS: $[400,000 - 10,000] / 200,000 \text{ shares} = \1.95 per share

Diluted EPS: $[400,000 + (30,000 \times 0.6)] / [200,000 + 10,000 + 15,000] = \1.86 per share

Question #59 of 87

Question ID: 414093

The first-in-first-out (FIFO) expense recognition method for inventories *best* describes the physical flow of goods if customers typically purchase units:

- X **A) selectively from among all units for sale.**
- X **B) from the top of a stack.**
- ✓ **C) in the same order the units are produced.**

Explanation

The FIFO cost flow method best approximates the physical flow of goods if customers typically purchase units in the order the units are produced, such as goods with a limited shelf life. Last-in-first-out (LIFO) best approximates the flow of goods if customers purchase units from the top of a stack, as with raw materials such as coal or gravel. If customers choose individual units selectively from among all the units for sale, the flow of goods may be unclear and the average cost method may describe it best.

Question #60 of 87

Question ID: 414201

Selected information from Gerrard, Inc.'s financial activities in the most recent year was as follows:

- Net income was \$330,000.
- The tax rate was 40%.
- 700,000 shares of common stock were outstanding on January 1.
- The average market price per share for the year was \$6.
- Dividends were paid during the year.
- 2,000 shares of 8% \$500 par value preferred shares, convertible into common shares at a rate of 200 common shares for each preferred share, were outstanding for the entire year.
- 200,000 shares of common stock were issued on March 1.

Gerrard, Inc.'s diluted earnings per share (diluted EPS) was *closest* to:

- ✓ **A) \$0.261.**
X **B) \$0.289.**
X **C) \$0.197.**

Explanation

To compute Gerrard's basic earnings per share (EPS) ((net income - preferred dividends) / weighted average common shares outstanding), the weighted average common shares outstanding must be computed. 700,000 shares were outstanding from January 1, and 200,000 shares were issued on March 1, so the weighted average is $700,000 + (200,000 \times 10 / 12) = 866,667$. Basic EPS was $\$330,000 - (2,000 \times \$500 \times 0.08) / 866,667 = \0.289 .

If the convertible preferred shares were converted to common stock, $2,000 \times 200 = 400,000$ additional common shares would have been issued and dividends on the preferred stock would not have been paid. Diluted EPS was $\$330,000 / (866,667 + 400,000) = \0.261 .

Question #61 of 87

Question ID: 414140

A firm had the following numbers of shares outstanding during the year:

Beginning of year	8,000,000 shares
Issued on April 1	750,000 shares
Paid stock dividend of 20% on July 1	

Issued on October 1	100,000 shares
Purchased Treasury stock November 1	1,000,000 shares
Split 2 for 1 on December 31	

Based on this information, what is the weighted number of shares outstanding for the year?

- ✓ **A) 20,266,667.**
- ✗ **B) 42,444,444.**
- ✗ **C) 20,783,333.**

Explanation

Outstanding all year	$8,000,000 \times 1.2 \times 2 \times 1.0$	19,200,000
Outstanding for 0.75 years	$750,000 \times 1.2 \times 2 \times 0.75$	1,350,000
Outstanding for 0.25 years	$100,000 \times 2 \times 0.25$	50,000
Retired for 2 months	$-1,000,000 \times 2 \times (2/12)$	-333,333
Weighted average number of shares for year:		20,266,667

Question #62 of 87

Question ID: 414137

At the beginning of 2004, Osami Corporation had 1.4 million shares of common stock outstanding and no preferred stock. At the end of August 2004, Osami issued 1.2 million new shares of common stock. If Osami reported net income equal to \$7.2 million, what were its earnings per share (EPS) for 2004?

- ✗ **A) \$3.33.**
- ✗ **B) \$2.77.**
- ✓ **C) \$4.00.**

Explanation

The new shares were only outstanding 4 months of the year. Thus, the weighted average number of shares outstanding is $[1.4 + (4/12)(1.2)]$ million = 1.8 million shares. So basic EPS = \$7.2 million / 1.8 million = \$4.00.

Question #63 of 87

Question ID: 414066

Which of the following is NOT a requirement for revenue recognition to occur?

- ✓ **A) Cash must have been received.**
- X **B) Transactions giving rise to revenue should be arms-length.**
- X **C) Earning activities are substantially completed.**

Explanation

Revenue from credit sales may be recognized when sales are on account.

Other conditions when revenues are also considered earned include when: revenue can be measured with reasonable accuracy, transactions are not subject to revocation, it is possible to measure the cost of provided goods (no significant contingent obligation), and there is assurance of payment (cash) or collectability.

Question #64 of 87

Question ID: 414227

Are dividends paid to common shareholders and foreign currency translation gains and losses included in a firm's other comprehensive income?

- | | <u>Dividends paid</u> | <u>Foreign currency translation gains and losses</u> |
|-----------------|-----------------------|--|
| X A) No | | No |
| X B) Yes | | Yes |
| ✓ C) No | No | Yes |

Explanation

Other comprehensive income includes non-owner transactions that affect shareholders' equity and are not recognized in net income. Dividends paid are transactions with the owners of the firm, so dividends paid are not included in other comprehensive income. Foreign currency translation gains and losses are non-owner transactions that are not recognized in net income. Thus, foreign currency translation gains and losses are included in other comprehensive income.

Question #65 of 87

Question ID: 414122

An analyst gathered the following information about a company:

- 01/01/04 - 50,000 shares issued and outstanding at the beginning of the year
- 04/01/04 - 5% stock dividend
- 10/01/04 - 10% stock dividend

What is the company's weighted average number of shares outstanding at the end of 2004?

- X **A) 55,000.**
- X **B) 57,500.**
- ✓ **C) 57,750.**

Explanation

The weighted average number of common shares outstanding is the number of shares outstanding during the year weighted by the portion of the year they were outstanding. Dividends and splits are applied to all shares issued or repurchased and all original

or adjusted shares outstanding prior to the split or dividend.

Step 1) Apply the 04/01/04 dividend to the beginning-of-year shares: Adjusted shares = $1.05 \times 50,000 = 52,500$

Step 2) Apply the 10/01/04 dividend the adjusted beginning-of-year shares. Adjusted beginning of year shares = $57,750 (= 1.1 \times 52,500)$.

Step 3) Compute the weighted average number of shares. $57,750 \times (12/12) = 57,750$ shares.

Question #66 of 87

Question ID: 414129

The standard equation for computing basic earnings per share (EPS) is:

- ☐ A) $[\text{Net Income} - \text{Common Dividends}] / \text{Weighted Average Number of Common Shares Outstanding}$.
- ☐ B) $[\text{Sales} - \text{Cost of Goods Sold}] / \text{Number of Preferred Shares Outstanding}$.
- ☒ C) $[\text{Net Income} - \text{Preferred Dividends}] / \text{Weighted Average Number of Common Shares Outstanding}$.

Explanation

The basic EPS calculation does not consider the effects of any dilutive securities in the computation.

Basic EPS = $[\text{Net Income} - \text{Preferred Dividends}] / \text{Weighted Average Number of Common Shares Outstanding}$.

Question #67 of 87

Question ID: 414155

Lawson, Inc.'s net income for the year was \$1,060,000 with 420,000 shares outstanding. Lawson has 2,000 shares of 8%, \$1,000 par value convertible preferred stock that were outstanding the entire year. Each share of preferred is convertible into 50 shares of common stock. Lawson's diluted earnings per share are *closest* to:

- ☐ A) \$1.94.
- ☒ B) \$2.04.
- ☐ C) \$2.14.

Explanation

Lawson's basic EPS $((\text{net income} - \text{preferred dividends}) / \text{weighted average common shares outstanding})$ is $(\$1,060,000 - (2,000 \times \$1,000 \times 0.08)) / 420,000 = \2.14 . To calculate diluted EPS the convertible preferred shares are presumed to have been converted, the preferred dividends paid are added back to the numerator of the EPS equation, and the additional common shares are added to the denominator of the equation. Lawson's diluted EPS is $\$1,060,000 / (420,000 + 100,000) = \2.04 .

Question #68 of 87

Question ID: 414179

Nichols Company's net income for 20X6 was \$978,000 with 1,250,000 shares outstanding. The average share price in 20X6 was \$8.50. Nichols issued 2,000 warrants to purchase 100 shares each for \$10 per share in 20X5. Nichols Company's diluted earnings per share (diluted EPS) for 20X6 is *closest* to:

- ☐ A) \$0.777.

✓ **B)** \$0.782.

X **C)** \$0.793.

Explanation

Nichols basic EPS (net income / weighted average common shares outstanding) was:

$$\$978,000 / 1,250,000 = \$0.782.$$

Because the exercise price of the warrants is higher than the average share price, the warrants are antidilutive and are excluded from diluted EPS. Because there were no other potentially dilutive securities, Nichols' diluted EPS in 20X6 is the same as basic EPS.

Question #69 of 87

Question ID: 414081

Information about a company's revenue recognition policies is *most likely* disclosed in:

X **A)** Management's Discussion and Analysis.

✓ **B)** the financial statement notes.

X **C)** the standard auditor's report.

Explanation

Revenue recognition policies are disclosed in the footnotes to the financial statements.

Question #70 of 87

Question ID: 414194

Securities that would decrease earnings per share (EPS) if they were exercised and converted to common stock are called:

X **A)** antidilutive securities.

X **B)** synthetic securities.

✓ **C)** dilutive securities.

Explanation

Dilutive securities are securities that decrease EPS if they are exercised or converted to common stock. Stock options, warrants, convertible debt, and convertible preferred stock are examples of dilutive securities.

Question #71 of 87

Question ID: 414072

An analyst has gathered the following data pertaining to Hegel Company's construction projects, which began during 20X2:

	<u>Project 1</u>	<u>Project 2</u>
Contract price	\$420,000	\$300,000
Costs incurred in 20X2	240,000	280,000
Estimated costs to complete	120,000	40,000
Billed to customers during 20X2	150,000	270,000

Received from customers during 20X2	90,000	250,000
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If Hengel used the completed contract method, what amount of gross profit (loss) would Hengel report in its 20X2 income statement for:

	<u>Project 1</u>	<u>Project 2</u>
✓ A) \$0		(\$20,000)
X B) \$0	\$0	
X C) (\$20,000)	\$0	

Explanation

No profit is recognized until the completion of the project; however, expected losses are recognized. Project 2 has an expected loss of \$20,000.

Question #72 of 87

Question ID: 414077

Which, if any, of the following statements about the installment sales method and cost recovery method is correct?

Statement 1: The cost recovery method recognizes revenue and associated costs of goods sold only when cash is received, based on gross profit margin.

Statement 2: The installment sales method recognizes sales when cash is received, but no gross profit is recognized until all of the cost of goods sold is collected.

- ✓ **A) Neither statement is correct.**
- X **B) Both statements are correct.**
- X **C) Only one of these statements is correct.**

Explanation

Neither statement is correct because the definitions are reversed.

Question #73 of 87

Question ID: 414103

Which of the following items regarding the corporate income statement is *most* accurate?

- X **A) Examples of extraordinary items include expropriations of property and equipment by foreign governments, losses from earthquakes and tornados, and gains from the sale of investments in subsidiaries.**
- ✓ **B) Unusual or infrequent items appear in the income statement of a corporation as a component of net income from continuing operations.**
- X **C) If a corporation disposes of a business segment that is separable from the company's core business activities, the results of the discontinued segment are reported as a separate line item below income from continuing operations on a pre-tax basis.**

Explanation

Explanations for *incorrect* answers are as follows:

- The gain on the sale of a subsidiary is an *unusual or infrequent item*.
- The results of a discontinued segment are reported below the line, net of tax (after tax).

Question #74 of 87

Question ID: 414084

An airplane manufacturing company routinely builds fighter jets for the U.S. armed forces. It takes fourteen months to build one jet, and the government pays for them in installments over the fourteen-month period. Which revenue recognition method should be used?

- ✓ **A) Percentage-of-completion method.**
- X **B) Installment sales method.**
- X **C) Completed contract method.**

Explanation

The percentage-of-completion method is appropriate in this case because payment is assured when dealing with the U.S. government, and cost and price estimates are assumed reliable due to the ongoing and routine nature of the contract.

Question #75 of 87

Question ID: 414148

Bluff, Inc.'s stock transactions during the year were as follows:

- January 1 90,000 common shares outstanding.
- April 1 20% stock dividend is declared and issued.
- October 1 10,000 shares are reacquired as treasury stock.

What is Bluff's weighted average number of shares outstanding during the year?

- X **A) 101,000.**
- ✓ **B) 105,500.**
- X **C) 98,000.**

Explanation

Initial shares: $90,000 \times 1.20 =$	108,000
- Reacquired treasury shares: $10,000 \times 3/12 =$	<u>-2,500</u>
	105,500

Question #76 of 87

Question ID: 414130

The following information pertains to Bender, Inc., for last year:

- Net income of \$25 million.
- 1 million shares of \$10 par value preferred stock outstanding paying a 10% dividend.

- 50 million shares of common stock outstanding at the beginning of the year.
- Issued an additional 5 million shares of common stock on 7/1.

What is Bender, Inc.'s basic earnings per share (EPS)?

- ✓ **A) \$0.457.**
- X B) \$0.384.
- X C) \$0.476.

Explanation

50,000,000 common shares × 12 months = 600,000,000

5,000,000 common shares × 6 months = 30,000,000 = 630,000,000

630,000,000 / 12 = 52,500,000 average shares

$[\$25,000,000(\text{NI}) - \$1,000,000(\text{preferred dividends})] / 52,500,000 \text{ shares} = \$24,000,000 / 52,500,000 = \0.457

Question #77 of 87

Question ID: 414189

In calculating the numerator for diluted Earnings Per Share, the interest on convertible debt is:

- ✓ **A) added to earnings available to common shareholders after an adjustment for taxes.**
- X B) subtracted from earnings available to common shareholders after an adjustment for taxes.
- X C) added to earnings available to common shareholders.

Explanation

Formula = Diluted EPS = $[(\text{Net income} - \text{Preferred dividends}) + \text{Convertible preferred dividends} + (\text{Convertible debt interest})(1 - t)] / [(\text{Weighted average shares}) + (\text{Shares from conversion of conv. pfd shares}) + (\text{Shares from conversion of conv. debt}) + (\text{Shares issuable from stock options})]$

Question #78 of 87

Question ID: 414224

For the year ended December 31, 2007, Cobra Company reported the following financial information:

Revenue	\$100,000
Cost of goods sold	40,000
Operating expenses	20,000
Unrealized gain from foreign currency translation	5,000
Unrealized loss on cash flow hedging derivatives	3,000
Dividends paid to common shareholders	7,500
Realized gain on sale of equipment	1,000

Ignoring taxes, calculate Cobra's net income and comprehensive income for 2007.

Net income Comprehensive income

- ☐ **A) \$40,000** **\$43,000**
- ☒ **B) \$41,000** **\$43,000**
- ☐ **C) \$41,000** **\$2,000**

Explanation

Net income is equal to \$41,000 (\$100,000 revenue - \$40,000 COGS - \$20,000 operating expenses + \$1,000 realized gain on sale of equipment). Comprehensive income includes all transactions that affect stockholders' equity except transactions with shareholders. Comprehensive income includes net income, unrealized gains and losses from available-for-sales securities, unrealized gains and losses from cash flow hedging derivatives, and gains and losses from foreign currency translation. Thus, comprehensive income is equal to \$43,000 (\$41,000 net income + \$5,000 unrealized gain from foreign currency translation - \$3,000 unrealized loss from cash flow hedging derivatives). Dividends paid is a transaction with shareholders and is not included in comprehensive income.

Question #79 of 87

Question ID: 414074

Cash collection is a critical event for income recognition under the:

Cost-Recovery Method Installment Method

- | | |
|--|------------|
| <input checked="" type="radio"/> A) Yes | Yes |
| <input type="radio"/> B) Yes | No |
| <input type="radio"/> C) No | Yes |

Explanation

Recognition of income depends on cash collected under both methods.

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Question ID: 414128

Connecticut, Inc.'s stock transactions during the year 20X5 were as follows:

- January 1: 360,000 common shares outstanding.
- April 1: 1 for 3 reverse stock split.
- July 1: 60,000 common shares issued.

When computing for earnings per share (EPS) computation purposes, what is Connecticut's weighted average number of shares outstanding during 20X5?

- ☐ **A) 140,000.**
- ☐ **B) 210,000.**
- ☒ **C) 150,000.**

Explanation

Connecticut's January 1 balance of common shares outstanding is adjusted retroactively for the 1 for 3 reverse stock split, meaning there are $(360,000 / 3) = 120,000$ "new" shares treated as if they had been outstanding since January 1. The weighted average of the shares

issued in July, $(60,000 \times 6 / 12) = 30,000$ is added to that figure, for a total of 150,000.

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Question ID: 414163

Assume that the exercise price of an option is \$10, and the average market price of the stock is \$13. Assuming 999 options are outstanding during the entire year, what is the number of shares to be added to the denominator of the diluted earnings per share (EPS)?

- ☐ A) 999.
- ☐ B) 768.
- ☒ C) 231.

Explanation

$$(999)(10) = 9,990$$

$$9,990 / 13 = 768$$

$$999 - 768 = 231$$

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Question ID: 414203

Based on the following data, how many shares of common stock should be used to calculate diluted earnings per share?

- Net income of \$1,500,000, tax retention rate of 60%
- 1,000,000 shares of common are outstanding at the beginning of the year.
- 10,000, 6% convertible bonds with each bond convertible into 20 shares of common stock were issued at par (\$100) on June 30th of this year.
- The firm has 100,000 warrants outstanding all year with an exercise price of \$25 per share.
- The average stock price for the period is \$20, and the ending stock price is \$30.

- ☒ A) 1,100,000.
- ☐ B) 1,266,667.
- ☐ C) 1,000,000.

Explanation

First, Check for dilution: Basic EPS = $1,500,000 / 1,000,000 = 1.50$

Warrants: anti-dilutive since the average stock price is less than the exercise price

Convertible bonds: **numerator impact** = $(\# \text{ bonds}) \times (\text{par value}) \times (\text{interest rate}) \times (\text{tax retention rate}) \times (0.5 \text{ for } 1/2 \text{ year outstanding}) = (10,000) \times (100) \times (0.06) \times (0.6) \times (0.5) = 18,000$, so the numerator = 1,518,000 **Denominator impact:** increase in average shares = $[(\# \text{ bonds}) \times (\text{conversion factor}) \times (\# \text{ months outstanding})] / 12 = (1,200,000 / 12 = 100,000)$ so, the denominator = 1,100,000 and EPS with conversion = $1,518,000 / 1,100,000 = 1.38$, which is less than 1.50. The bonds are dilutive and the diluted EPS calculation should use 1,100,000 shares of common stock in the denominator. The warrants are out of the money based on the average price of \$20.

Question #83 of 87

Question ID: 434273

Zichron, Inc., had the following equity accounts on December 31:

- Common stock: 20,000 shares.
- Preferred stock A: 10,000 shares convertible into common on a 2 for 1 basis, dividend of \$40,000 was declared during the year.
- Preferred stock B: 10,000 shares, convertible to common on a 4 for 1 basis, dividend of \$5,000 was declared during the year.
- The company reported net income of \$120,000 and paid a \$20,000 dividend to its common shareholders.

Diluted earnings per share for the year are:

- ☐ A) \$1.33.
- ☐ B) \$3.00.
- ☒ C) \$1.50.

Explanation

Basic EPS = $(\$120,000 - \$40,000 - \$5,000) / 20,000 = \3.75 .

Convertible preferred stock A: $\$40,000 / 2(10,000) = \2.00 , which is less than basic EPS so the convertible preferred stock is dilutive.

Convertible preferred stock B: $\$5,000 / 4(10,000) = \0.125 , which is less than basic EPS so the convertible preferred stock is dilutive.

Diluted EPS = $\$120,000 / [20,000 + 2(10,000) + 4(10,000)] = \1.50 .

Question #84 of 87

Question ID: 414213

An analyst compiled the following information from Hampshire, Inc.'s financial activities in the most recent year:

- Net income was \$2,800,000.
- 100,000 shares of common stock were outstanding on January 1.
- The average market price per share for the year was \$250.
- 10,000 shares of 6%, \$1,000 par value preferred shares were outstanding the entire year.
- 10,000 warrants, which allow the holder to purchase 10 shares of common stock for each warrant held at a price of \$150 per common share, were outstanding the entire year.
- 30,000 shares of common stock were issued on September 1.

Hampshire, Inc.'s diluted earnings per share are *closest* to:

- ☐ A) \$20.00.
- ☒ B) \$14.67.
- ☐ C) \$18.38.

Explanation

To compute Hampshire's basic EPS ((net income - preferred dividends) / weighted average common shares outstanding), the weighted average common shares must be computed. 100,000 shares were outstanding from January 1, and 30,000 shares were issued on September 1, so the weighted average is $100,000 + (30,000 \times 4 / 12) = 110,000$. Basic EPS is $(\$2,800,000 - (10,000 \times \$1,000 \times 0.06)) / 110,000 = \20.00 .

If the warrants were exercised, cash inflow would be $10,000 \times \$150 \times 10 = \$15,000,000$ for $10 \times 10,000 = 100,000$ shares. Using the treasury stock method, the number of Hampshire shares that can be purchased with the cash inflow (cash inflow / average

share price) is $\$15,000,000 / \$250 = 60,000$. The number of shares that would be created is $100,000 - 60,000 = 40,000$. Diluted EPS is $\$2,200,000 / (110,000 + 40,000) = \14.67 .

Question #85 of 87

Question ID: 414127

The following data pertains to the McGuire Company:

- Net income equals \$15,000.
- 5,000 shares of common stock issued on January 1.
- 10% stock dividend issued on June 1.
- 1000 shares of common stock were repurchased on July 1.
- 1000 shares of 10%, par \$100 preferred stock each convertible into 8 shares of common were outstanding the whole year.

What is the company's basic earnings per share (EPS)?

- ☐ A) \$1.20.
- ☐ B) \$2.50.
- ☒ C) \$1.00.

Explanation

Number of average shares:

1/1 5,500 shares issued (includes 10% stock dividend on 6/1) $\times 12 = 66,000$
7/1 1,000 shares repurchased $\times 6$ months = 6,000
 $66,000 - 6,000 = 60,000$
 $60,000 \text{ shares} / 12 \text{ months} = 5,000 \text{ average shares}$

Preferred dividends = $(\$10)(\$1,000) = \$10,000$

Basic EPS = $[\$15,000(\text{NI}) - \$10,000(\text{preferred dividends})] / 5,000 \text{ shares} = \$5,000 / 5,000 \text{ shares} = \$1/\text{share}$

Question #86 of 87

Question ID: 414160

When considering the impact of warrants on earnings per share, the method to calculate the number of shares added to the denominator is derived using which method?

- ☐ A) Weighted average method.
- ☐ B) Cost recovery method.
- ☒ C) Treasury Stock method.

Explanation

The treasury stock method assumes the hypothetical funds received by the company from the exercise of the options are used to purchase shares of the company's common stock in the market at the average market price.

Question #87 of 87

Question ID: 414158

Stanley Corp. had 100,000 shares of common stock outstanding throughout 2004. It also had 20,000 stock options with an exercise price of \$20 and another 20,000 options with an exercise price of \$28. The average market price for the company's stock was \$25 throughout the year. The stock closed at \$30 on December 31, 2004. What are the number of shares used to calculate diluted earnings per share for the year?

X **A) 105,000.**

✓ **B) 104,000.**

X **C) 110,000.**

Explanation

Only the stock options with an exercise price of \$20 are dilutive. The additional shares of 4,000 ($20,000 - [(20,000 \times 20) / 25]$) are added to the 100,000 common shares outstanding.