ACCOUNTING 203  
Chapter 14 Practice Test

True and False Questions

1. Horizontal analysis involves comparing two or more years’ financial data for a single company.
2. Common-size statements are statements of companies of similar size and operations.
3. The gross margin percentage is computed by dividing the gross margin by sales.
4. The dividend payout ratio is equal to the current earnings per share divided by the dividend per share.
5. When computing the price-earnings ratio, the current market price of common stock is used.

Multiple Choice Questions

6. The formula for the gross margin percentage is:
   A) (Sales- Cost of goods sold)/ Cost of goods sold
   B) (Sales-Cost of goods sold)/Sales
   C) Net income/ Sales
   D) Net income? Cost of goods sold

7. Which of the following is not a potential source of financial leverage?
   A) Long-term debt.
   B) Common stock.
   C) Preferred stock.
   D) Current liabilities.

8. Issuing new shares of stock in a five-for-one split of common stock would:
   A) decrease the book value per share of common stock.
   B) increase the book value per share of common stock.
   C) increase total stockholders’ equity.
   D) decrease total stockholders’ equity.

9. A company’s current ratio and an acid-test ratio are both greater than 1. Payment of an account payable of $64,500 would:
   A) increase the current ratio but the acid-test ratio would not be affected.
   B) increase the acid-test ratio but the current ratio would not be affected.
   C) increase both the current and acid-test ratios.
   D) decrease both the current and acid-test ratios.
10. What is the effect of a purchase of inventory on account on the current ratio and on working capital, respectively? (Assume a current ratio greater than one prior to this transaction.)

\[
\begin{array}{ll}
\text{Current ratio} & \text{Working capital} \\
A) & \text{decrease} \quad \text{no effect} \\
B) & \text{no effect} \quad \text{decrease} \\
C) & \text{decrease} \quad \text{decrease} \\
D) & \text{no effect} \quad \text{no effect}
\end{array}
\]

11. Which of the following transactions will increase a company’s current ratio?
A) Selling equipment at book value.
B) Paying off short-term creditors.
C) Selling equipment at a loss.
D) Responses a, b, and c are all correct.

12. Assuming stable business conditions, an increase in the accounts receivable turnover ratio could be explained by:
A) stricter policies with respect to the granting of credit to customers.
B) an easing of policies with respect to the granting of credit to customers.
C) a slowdown in collecting accounts receivables from customers.
D) none of these.

13. Aristotle Company’s net income last year was $400,000. The company has 150,000 shares of common stock and 50,000 shares of preferred stock outstanding. There was no change in the number of common or preferred shares outstanding during the year. The company declared and paid dividends last year of $1.10 per share on the common stock and $0.40 per share on the preferred stock. The earnings per share of common stock is closest to:
A) $2.67.
B) $1.57.
C) $2.53.
D) $2.80.

14. Arundel Company’s net income last year was $300,000. The company has 100,000 shares of common stock and 30,000 shares of preferred stock outstanding. There was no change in the number of common or preferred stock. The company declared and paid dividends last year of $1.90 per share on the common stock and $1.70 per share on the preferred stock. The earnings per share of common stock is closest to:
A) $3.51.
B) $1.10.
C) $2.49.
D) $3.00.

15. The following data have been taken from your company’s financial records for the current year:
Earnings per share ........... $8
Market price per share ...... $60
Dividend per share .......... $6
Book value per share ........ $75

The price-earnings ratio is:
A) 7.5 to 1.
B) 10.0 to 1.
C) 9.4 to 1.
D) 13.3 to 1.

16. Drake Company’s working capital is $22,000 and its current liabilities are $98,000. The company’s current ratio is closest to:
A) 5.45 to 1.
B) 0.78 to 1.
C) 1.22 to 1.
D) 0.22 to 1.

17. Eraw Company has $15,000 in cash, $7,000 in marketable securities, $26,000 in current receivables, $23,000 in inventories, and $36,000 in current liabilities. The company’s acid-test (quick) ratio is closest to:
A) 1.33 to 1.
B) 1.14 to 1.
C) 0.72 to 1.
D) 1.97 to 1.

18. Grand Company had $120,000 in sales on account last year. The beginning accounts receivable balance was $18,000 and the ending accounts receivable balance was $14,000. The company’s average collection period (age of receivables) was closest to:
A) 97.33 days.
B) 48.67 days.
C) 42.58 days.
D) 54.75 days.

19. The following pertain to Bass Co.:

| Merchandise purchased | $1,800,000 |
| Cost of goods sold | $2,000,000 |
| Inventory at the end of the year | $400,000 |

The inventory turnover for the year was:
A) 10.0 times.
B) 5.0 times.
C) 4.0 times.
D) 3.6 times.
20. Harper Company, a retailer, had cost of goods sold of $190,000 last year. The beginning inventory balance was $22,000 and the ending inventory balance was $28,000. The company’s inventory turnover was closest to:
A) 6.79 times.
B) 7.60 times.
C) 3.80 times.
D) 8.64 times.

Use the following to answer questions 21 to 23.

Selected financial data from Hammond Company for the most recent year appear below:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$100,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>$60,000</td>
</tr>
<tr>
<td>Dividends declared and paid</td>
<td>$5,000</td>
</tr>
<tr>
<td>Interest expense</td>
<td>$8,000</td>
</tr>
<tr>
<td>Operating expense</td>
<td>$18,000</td>
</tr>
</tbody>
</table>

The income tax rate is 30%.

21. Net operating income as a percentage of sales was closest to:
A) 14%.
B) 17%.
C) 22%.
D) 9%.

22. Net income as a percentage of sales was closest to:
A) 22%.
B) 14%.
C) 40%.
D) 10%.

23. Gross margin as a percentage of sales was closest to:
A) 40%.
B) 45%.
C) 35%.
D) 22%.

Answers:
True and False

Multiple Choice