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Managerial Accounting and Finance Mid-Term Exam

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Summer 2022

### Short Answer

**1. What role does the Balance Sheet play in finance?**

The balance sheet is a snapshot of an organization's financial position. It includes assets, liabilities, and the resulting ownership position or net worth. This statement is used to measure the organization's ability to meet its current and future obligations.

**2. Speak to the relationship between a company's assets and liabilities and what this means as it relates to a company's bottom line.**

The difference between a company's assets and liabilities determines its bottom line; Specifically, the calculation formula is 'Assets = Liabilities + Shareholders' Equity' or can be revised to read 'Assets – Liabilities = Shareholders' Equity'. If assets exceed liabilities, the company will have a positive ownership position. If liabilities exceed assets, then the company will owe more than it owns.

**3. What is a fixed asset? Give a few examples of such and the length of time an asset of this nature is to last.**

Fixed assets are assets owned by the company that are used in the operation of the business and are expected to last more than one year. Some examples of fixed assets are real estate, equipment, or vehicles owned by the company and used for the business.

**4. What is straight line depreciation and how is it calculated?**

Straight line depreciation refers to depreciation that is recorded as the same amount for each year. It is calculated by dividing the cost of the expenditure by the estimated number of years the equipment will be useful. For example, if the equipment costs \$200,000 and is expected to last 8 years, depreciation will be recorded as \$25,000 per year ( $\$200,000/8$ ).

**5. What are the similarities and differences between preferred and common stock?**

Common stock holders are owners of the company, while preferred stock holders are not. Therefore, common stock holders can vote for its board of directors, while preferred stock holders cannot. When the company's cash is tight, holders of preferred stock receive priority in payment of their dividends over common stock holders. Preferred stock is also given priority in the event that the company files for bankruptcy; in that case, they would get their funds returned first. Preferred stock holders receive an

indicated but not guaranteed dividend; Due to this risk, it yields a higher return. Preferred stock is usually associated with mature businesses that have a predictable cash flow. Preferred stock holders have the option to convert their shares into common stock.

**6. What is the main difference between short-term and long-term debt for a company? Give examples of each type of debt.**

Short-term debt is due in less than one year; it is usually used to cover current cash needs, seasonal cash flow needs and major customer orders. Long-term debt is debt that is due in more than one year; it can be used to finance things like major capital expansions, research and development projects with longer time horizons, and real estate.

**7. What contributions did the Gilbert Brothers offer to the business world and stockholders of companies in particular?**

John and Lewis Gilbert contributed to the business world by dedicating their lives to advocating for shareholders. They initiated or influenced a number of improvements that caused boards of directors to be accountable to shareholders. Some examples include:

- Members of the board of directors should own stock in the company.
- Shareholder meetings should take place in a location that is convenient for shareholders.
- Shareholders can ask questions at meetings and expect answers to their questions.
- Auditors are elected by the shareholders, not by management.
- Audited financial statements must be received by stockholders prior to the annual meeting.

**8. What role does the Securities and Exchange Commission play in overseeing business practices? Who reports to the SEC?**

The SEC is an agency that ensures fairness in the securities markets. Companies with assets of at least \$10 million whose securities are held by more than 500 independent shareholders are required to file with the SEC. In doing so, shareholders benefit from gaining access to information the companies filed with the SEC, as well as the ability to seek recovery of damages if they invest in the company as a result of misleading, incomplete, or inaccurate information.

**9. What value does a Current Ratio play for a company? What does a Current Ratio below 1.0 mean?**

The current ratio represents the ratio of current assets to current liabilities. A current ratio below 1.0 means that current assets are less than current liabilities.

**10. What is the main difference between a Quick Ratio and the Current Ratio? Why might a Quick Ratio test be better off for a company's starting point?**

A quick ratio is calculated the same way a current ratio is calculated, except it does not include inventory. It might be better to perform this test at startup so that it can help with

estimating a reasonable cost for inventory and guidelines for extending credit to customers.

**11. During the economic turmoil of 2008 and 2009 many United States citizens took part in flipping properties. What were the advantages and disadvantages of purchasing and selling homes during this time frame?**

Advantages:

- Many people holding mortgage debt of 90% or higher made a lot of money – in some cases, they doubled their return on equity.
- Private equity firms benefited from purchasing loan-defaulted homes and renting them to families that lost their homes during the recession.

Disadvantages:

- When there were no more buyers, some people who held properties that they hadn't flipped yet lost their investment (and then some) because their mortgage debt exceeded the value of their properties.

**12. What is the value in a company knowing its Revenue per Employee ratio? How is this ration calculated?**

Revenue per employee is an important metric that allows companies to estimate an ideal revenue for each employee to generate. When a company gets as much productivity per employee as possible, it can increase profitability while avoiding the costs of hiring additional employees that would eat up corporate profits through increased wages and inflation. The formula for calculating revenue per employee is:

'Revenue per Employee = Annual Corporate Revenue/Total Employees'

**13. How does After Tax Cash Flow and Total Assets work with one another when trying to determine the ROA of a profit Center?**

After tax cash flow is divided by the assets to arrive at the return on assets. In other words, ROA is calculated using the following formula:

'Return on Assets = After-Tax Cash Flow / Assets'

**14. How does a company go about determining how much inventory is needed to maintain a competitive advantage within the marketplace?**

Companies can get an idea of how much inventory is needed by calculating the inventory turnover ratio. It is not an exact answer for how much inventory to carry, but it provides a useful figure to work from by relying on historical inventory costs over the past year. The inventory turnover ratio is calculated using the following formula:

'Inventory Turnover = Cost of Goods Sold/Average Inventory'

**15. What has been the most valuable source of information you have learned from the course to date? How will you use this information to be more aware in the areas of finance and accounting?**

The most valuable information I have learned so far

**Income Statement**

*(See Excel sheet titled “Balance Sheet and Income Statement\_K. Chalumeau\_”)*

**Balance Sheet**

*(See Excel sheet titled “Balance Sheet and Income Statement\_K. Chalumeau\_”)*

**Essay**

*(See Word document titled “Essay\_K. Chalumeau”)*