



## Theory and Practice

Questions Appeared in: ModelOff 2012 Round 1

Time Allocated: 25 minutes

### INTRODUCTION

Answer each of the following questions relating to Financial Modeling Theory and Practice.

### GENERAL

#### Question 1

**What is a Financial Modeler's main objective when gathering internal information for a valuation?**

- a. To examine historical and projected financial data including Financial Statements, Income Tax Returns and Budgets
- b. To keep abreast of changing general economics to ascertain how it may impact the assumptions that are made during the valuation process
- c. Thorough analysis to gain an adequate understanding of the subject company's operational management and earnings ability
- d. To examine the current location(s) and physical condition of the subject company's facilities and operational assets

#### Question 2

**What is not a benefit of Financial Modeling standards?**

- a. Improved quality and transparency
- b. Decreased development time and costs
- c. Minimization of error risk
- d. Enforcement of model redundancy



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### VALUATION APPROACHES

#### Question 3

**The formula to calculate the percentage growth in sales is?**

- a. Period 2 net sales less period 1 net sales divided by period 1 net sales
- b. Period 1 net sales less period 2 net sales divided by period 1 net sales
- c. Period 1 net sales less period 2 net sales divided by period 2 net sales
- d. Period 2 net sales less period 1 net sales divided by period 2 net sales

#### Question 4

**The most conservative ratio in measuring a company's solvency is?**

- a. Current ratio
- b. Quick ratio
- c. Cash ratio
- d. Turnover ratio

#### Question 5

**Which method combines the income and asset based approaches to arrive at a value of a closely held business?**

- a. Book value
- b. Discounted cash flows
- c. Guideline public companies
- d. Excess earnings method

#### Question 6

**The cost to replace an asset under a particular fact situation is known as?**

- a. Fair market value
- b. Fair value
- c. Replacement cost
- d. Strategic value



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### Question 7

**During a Mergers and Acquisitions (M&A) transaction, the ability to find and use good comparable data for a valuation is?**

- a. Relatively easy because each successful company within an industry uses the same ratios
- b. Relatively easy because public stock price fluctuation is not sufficient or erratic enough to make a difference
- c. Relatively difficult because book value is adjusted in small companies as FIFO (first-in first-out) is the method of choice and in public companies book value is static due to LIFO (last-in-first our method)
- d. d. Relatively difficult because size differential, management depth product diversity and access to lines of credit will seldom match the company you are valuing

### Question 8

**When analyzing comparable companies, which valuation discount may be appropriate for a lack of liquidity in a private company?**

- a. Discount for lack of mobility
- b. Discount for lack of minority interest
- c. Discount for lack of marketability
- d. Discount for lack of maintenance

### Question 9

**In addition to control and marketability discounts/premiums, other modifications may include?**

- a. Key person discounts
- b. Lack of diversification discount
- c. Build-in gains discounts
- d. A and B

### Question 10

**When valuing the stock of a real estate holding company, most likely the Financial Modeler will give the greatest weight to which method?**

- a. Capitalization of earnings method
- b. Book value method
- c. Adjusted book value method
- d. Rule of thumb



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### NORMALIZATIONS AND ADJUSTMENTS

#### Question 11

**What is the best way to determine if a normalizing adjustment should be made to accounts receivable?**

- a. Common size the balance sheet
- b. Use trend analysis
- c. Look at accounts receivable ageing
- d. None of the above

#### Question 12

**Which one of the following is not a general category of normalized adjustments?**

- a. Removal of excess cash
- b. Inventory adjustment when inventory is recorded on a FIFO basis
- c. Reasonable compensation for owners
- d. Bad debt adjustment for a significant write off due to an unexpected bankruptcy filing by a major customer

#### Question 13

**Which of the following are typical categories to review in normalizing accounts for a valuation?**

- a. Doubtful accounts, notes receivable, leases
- b. Notes receivable, leases, compensation but not liabilities and insurance
- c. Inventory methods, depreciation methods but not non-operating items
- d. Capitalization and expensing, recognition of income, and expenses and taxes but not nonrecurring or extraordinary costs



## ModelOff 2012 Questions and Answers

### EARNINGS METHODS

#### Question 14

The next two questions use the following information (i.e. Question 14 and 15). Tom's Mining Equipment Inc has the following historical earnings:

Year	Earnings (\$m)
1	\$75,400
2	\$65,200
3	\$87,600
4	\$90,500
5	\$53,900

Which method of projecting earnings would appear most appropriate to estimate future benefits?

- a. Geometric progression
- b. Unweighted average method
- c. Trend Line – static method
- d. All of the above

#### Question 15

Estimate the future benefits, using the method you have selected in the previous question.

Tom's Mining Equipment Inc has the following historical earnings:

Year	Earnings (\$m)
1	\$75,400
2	\$65,200
3	\$87,600
4	\$90,500
5	\$53,900

- a. \$73,340m
- b. \$75,700m
- c. \$93,150m
- d. \$74,520m



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### FORMULAE AND TECHNIQUE

#### Question 16

**Which of the following is the concatenating operator?**

- a. Apostrophe (')
- b. Exclamation (!)
- c. Ampersand (&)
- d. Hash (#)

#### Question 17

**Which Excel feature may cause large financial models to recalculate slowly?**

- a. Array formulas
- b. Volatile functions
- c. Data tables
- d. All of the above

#### Question 18

**The formula =A\$7+\$A\$8 uses?**

- a. Absolute cell references
- b. Relative cell references
- c. Mixed cell references
- d. Indirect cell references

#### Question 19

**A combination of the following functions is often used in place of a VLOOKUP and HLOOKUP?**

- a. CHOOSE and INDIRECT
- b. SUMIF and INDEX
- c. INDEX and MATCH
- d. OFFSET and COUNTIF



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### Question 20

**If the third argument in an INDEX function is left blank?**

- a. The first cell in the column is returned
- b. The last cell in the column is returned
- c. The entire column is returned
- d. An error is returned

### Question 21

**Which of the following functions can be used in a simple formula that uses no other functions to return the first day of the following month?**

- a. EOMONTH
- b. NETWORKDAYS
- c. DATE
- d. DATEVALUE

### Question 22

**Which function can be used to simplify the following formula?  
=IF(A1=1,C1+D1,IF(A1=2,C2+D2,IF(A1=3,C3+C1,IF(A1=4,C1+D2,NA()))))**

- a. VLOOKUP
- b. OFFSET
- c. SUMIF
- d. CHOOSE

### Question 23

**Which of the following functions is not volatile in recent versions of Excel?**

- a. OFFSET
- b. INDIRECT
- c. INDEX
- d. RAND



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**Question 24**

**Which is not a common loop structure used in VBA?**

- a. DO WHILE ... LOOP
- b. FOR ... NEXT
- c. DO ... LOOP UNTIL
- d. SELECT ... CASE

**Question 25**

**By default, Excel VBA passes arguments to functions and procedures by?**

- a. Reference
- b. Value
- c. Absolute
- d. Relative





## Answers

1	C
2	D
3	A
4	C
5	D
6	C
7	D
8	C
9	D
10	C
11	C
12	B
13	A
14	B
15	D
16	C
17	D
18	A
19	C
20	C
21	A
22	D
23	C
24	D
25	A