

Adventis Financial Modeling Certification (FMC) Level 1 Practice Test (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

- 1. How is the current ratio calculated?**
 - A. Current liabilities / current assets**
 - B. Current assets + current liabilities**
 - C. Current assets / current liabilities**
 - D. Cash / current liabilities**
- 2. Net income is determined by subtracting which expenses from revenue?**
 - A. Only operating expenses**
 - B. Operating and non-operating expenses, and taxes**
 - C. COGS and corporate taxes only**
 - D. Cost of sales and marketing costs**
- 3. What is the effect of submitting an invoice to a customer?**
 - A. Accounts payable decreases; revenue increases**
 - B. Accounts receivable increases; cash decreases**
 - C. Accounts receivable increases; revenue increases**
 - D. Accounts payable increases; fixed assets decrease**
- 4. What does the EV/revenue ratio provide insight into?**
 - A. The relationship between a company's revenue and its earnings**
 - B. The comparison of a company's total value to its revenue**
 - C. The amount of investor equity in a company**
 - D. The company's dividend policy**
- 5. What does the days receivable ratio measure?**
 - A. The time taken to sell inventory.**
 - B. The average number of days invoices are in receivables before collection.**
 - C. The duration before a company pays its suppliers.**
 - D. The time taken to receive cash from sales.**

- 6. Cash flow from financing activities does NOT typically include which of the following?**
- A. Debt issuance**
 - B. Capital expenditures**
 - C. Dividends**
 - D. Share repurchases**
- 7. If a company has an operating margin ratio of 15%, what does it indicate?**
- A. The company loses money on every dollar of revenue**
 - B. For every \$1 of revenue, \$0.15 is converted to operating profit**
 - C. For every \$1 invested, \$0.15 of net income is produced**
 - D. The company maintains a net margin of 15%**
- 8. Which of the following is a liquidity ratio?**
- A. Gross profit margin**
 - B. Current ratio**
 - C. Debt-to-equity ratio**
 - D. Return on investment**
- 9. What does the net debt/EBITDA ratio typically indicate?**
- A. Net leverage**
 - B. Operating efficiency**
 - C. Marketvaluation**
 - D. Cash flow volatility**
- 10. What does working capital primarily measure?**
- A. A company's overall profitability**
 - B. A company's efficiency**
 - C. A company's long-term solvency**
 - D. A company's market share**

Answers

SAMPLE

- 1. C**
- 2. B**
- 3. C**
- 4. B**
- 5. B**
- 6. B**
- 7. B**
- 8. B**
- 9. A**
- 10. B**

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Explanations

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1. How is the current ratio calculated?

- A. Current liabilities / current assets
- B. Current assets + current liabilities
- C. Current assets / current liabilities**
- D. Cash / current liabilities

The current ratio is a key financial metric used to assess a company's ability to pay its short-term obligations. It is calculated by dividing current assets by current liabilities, which provides insight into the liquidity position of the business. Current assets are assets that are expected to be converted into cash or used within one year, such as cash, accounts receivable, and inventory. Current liabilities, on the other hand, are obligations that are due within the same time frame, including accounts payable and short-term debt. By expressing current assets in relation to current liabilities, the current ratio indicates whether a company has enough resources to cover its short-term debts. A ratio above 1 typically suggests that the company is in a good position to meet its obligations, while a ratio below 1 may signal potential liquidity issues. This calculation is critical for investors and creditors when evaluating the financial health and stability of a company, making the understanding of the current ratio essential for financial analysis and modeling.

2. Net income is determined by subtracting which expenses from revenue?

- A. Only operating expenses
- B. Operating and non-operating expenses, and taxes**
- C. COGS and corporate taxes only
- D. Cost of sales and marketing costs

Net income is calculated by taking total revenue and subtracting all relevant expenses incurred to generate that revenue. This includes operating expenses, which cover the day-to-day costs of running the business, and non-operating expenses, which can include interest, taxes, and other costs not directly tied to core business operations. Therefore, the correct answer reflects the comprehensive nature of expenses involved in calculating net income, which encompasses all operating and non-operating expenses, as well as taxes. Choosing this response highlights the importance of recognizing that net income is a measure of profitability that provides a complete picture of a company's financial performance. By including both types of expenses, you understand the total costs impacting the net income, leading to a more accurate financial analysis.

3. What is the effect of submitting an invoice to a customer?

- A. Accounts payable decreases; revenue increases
- B. Accounts receivable increases; cash decreases
- C. Accounts receivable increases; revenue increases**
- D. Accounts payable increases; fixed assets decrease

Submitting an invoice to a customer primarily results in two significant accounting effects: an increase in accounts receivable and an increase in revenue. When a business issues an invoice, it recognizes that it has delivered goods or provided services, thereby earning revenue, which is reflected in the income statement. At the same time, the business expects to receive payment from the customer in the future, increasing accounts receivable on the balance sheet. The increase in accounts receivable signifies that the company has a claim to cash that it will collect later, which is a key part of managing cash flow. The inclusion of both the increase in revenue and accounts receivable in this transaction accurately reflects the accrual accounting principle, where revenue is recognized when it is earned, rather than when cash is received. In contrast, options that suggest a decrease in accounts payable or cash decrease misinterpret the nature of the transaction. Accounts payable pertains to obligations the business owes to suppliers, not its customers, and cash does not decrease as a direct result of submitting an invoice. The fundamental accounting entries when an invoice is submitted highlight why the increase in accounts receivable and revenue is the correct response.

4. What does the EV/revenue ratio provide insight into?

- A. The relationship between a company's revenue and its earnings
- B. The comparison of a company's total value to its revenue**
- C. The amount of investor equity in a company
- D. The company's dividend policy

The EV/revenue ratio provides insight into the comparison of a company's total value to its revenue. This ratio is particularly useful for investors and analysts because it allows them to evaluate a company's valuation by considering its enterprise value (EV), which encompasses the total market capitalization as well as the company's debt, minus its cash and cash equivalents. By comparing this total value to the company's revenue, stakeholders can gain a sense of how much they are paying for each dollar of revenue generated by the company. This ratio is often utilized in sectors where companies may not yet be profitable, as it focuses exclusively on revenue rather than earnings. This makes it valuable for assessing companies in their growth phase or in industries with longer investment horizons. By using EV instead of just market capitalization, the ratio provides a more comprehensive view that can account for the company's capital structure and financing, leading to a clearer understanding of its relative valuation in comparison to similar companies.

5. What does the days receivable ratio measure?

- A. The time taken to sell inventory.
- B. The average number of days invoices are in receivables before collection.**
- C. The duration before a company pays its suppliers.
- D. The time taken to receive cash from sales.

The days receivable ratio is a financial metric that specifically measures the average number of days that a company takes to collect payments from its customers after a sale has been made. This ratio provides insights into a company's efficiency in managing its accounts receivable and its ability to convert sales into cash flow. A lower days receivable ratio indicates that a company is able to collect its receivables quickly, which is generally favorable for maintaining liquidity and ensuring the availability of cash for operations. Conversely, a higher ratio could suggest inefficiencies in the collections process or potential issues with credit quality of the company's customers. Understanding this metric is vital for businesses as it directly impacts cash flow management and overall financial health. It helps investors and management assess how well the company is performing in terms of credit policies and collection efforts. Therefore, it is essential to focus on the average number of days invoices are outstanding, which is exactly what this ratio measures.

6. Cash flow from financing activities does NOT typically include which of the following?

- A. Debt issuance
- B. Capital expenditures**
- C. Dividends
- D. Share repurchases

Cash flow from financing activities primarily involves transactions that affect a company's capital structure. This includes activities such as issuing or repaying debt, paying dividends, and buying back shares. Capital expenditures, on the other hand, relate to a company's investments in long-term assets like property, plant, or equipment aimed at improving or maintaining operations. These expenditures are classified under cash flow from investing activities rather than financing activities. This classification is crucial because it allows investors and analysts to distinguish between funding activities that alter the capital structure of the company and those that invest in the long-term operational capacity. Therefore, understanding that capital expenditures are not part of financing activities, but rather investing activities, is key to accurate financial analysis and modeling.

7. If a company has an operating margin ratio of 15%, what does it indicate?

- A. The company loses money on every dollar of revenue**
- B. For every \$1 of revenue, \$0.15 is converted to operating profit**
- C. For every \$1 invested, \$0.15 of net income is produced**
- D. The company maintains a net margin of 15%**

The operating margin ratio is a measure of a company's operational efficiency and profitability, reflecting the percentage of revenue that is left after covering operating expenses, which include both fixed and variable costs. An operating margin ratio of 15% indicates that for every dollar of revenue generated, the company retains \$0.15 as operating profit. This means that the remaining \$0.85 of each dollar in revenue goes towards covering all operating expenses, such as costs of goods sold, salaries, and rent. This understanding helps stakeholders gauge how effectively a company is managing its operations before accounting for interest and taxes. It also provides insight into the company's pricing strategy and cost structure, demonstrating how much profit can be achieved from operational activities alone. The context provided by this measurement allows investors and management to assess performance over time or against industry benchmarks, as a higher operating margin generally suggests a better conversion of sales into profit.

8. Which of the following is a liquidity ratio?

- A. Gross profit margin**
- B. Current ratio**
- C. Debt-to-equity ratio**
- D. Return on investment**

The current ratio is a liquidity ratio, which measures a company's ability to meet its short-term obligations using its most liquid assets. It is calculated by dividing current assets by current liabilities. This ratio provides insight into the company's short-term financial health and operational efficiency. By assessing the current ratio, stakeholders can determine whether a company has enough resources to cover its debts in the near term. A higher current ratio indicates a stronger liquidity position, suggesting that the company can easily settle its short-term liabilities without facing cash flow issues. In contrast, the other choices represent different financial metrics: gross profit margin measures profitability, the debt-to-equity ratio indicates financial leverage, and return on investment evaluates the efficiency of an investment. While all are important financial indicators, only the current ratio specifically addresses liquidity.

9. What does the net debt/EBITDA ratio typically indicate?

- A. Net leverage**
- B. Operating efficiency**
- C. Marketvaluation**
- D. Cash flow volatility**

The net debt/EBITDA ratio is a key financial metric used to assess a company's leverage, indicating how much debt the company has relative to its earnings before interest, taxes, depreciation, and amortization (EBITDA). This ratio effectively measures a company's ability to pay off its incurred debt with the earnings it generates from its operations. When calculating this ratio, net debt represents total debt minus cash and cash equivalents, providing a clearer picture of a company's indebtedness in relation to its operational income. A lower net debt/EBITDA ratio signifies a company with a more manageable level of debt in relation to its earnings, which typically indicates lower financial risk and potentially higher creditworthiness. Conversely, a higher ratio could point to greater leverage, which might raise concerns about the company's capacity to meet its debt obligations. Understanding this metric is crucial for investors and analysts as it provides insight into a company's capital structure and financial health, especially in industries where leverage plays a significant role in operations. While other financial metrics might focus on areas such as operating efficiency or cash flow volatility, the net debt/EBITDA ratio is primarily centered around assessing leverage, indicating how companies finance their operations with debt.

10. What does working capital primarily measure?

- A. A company's overall profitability**
- B. A company's efficiency**
- C. A company's long-term solvency**
- D. A company's market share**

Working capital primarily measures a company's efficiency in managing its short-term assets and liabilities. This concept reflects the liquidity of a business and its ability to cover its current obligations with its current resources. Efficient working capital management ensures that a company has enough cash flow to meet its short-term liabilities and invest in its day-to-day operations. By examining components such as inventory, accounts receivable, and accounts payable, working capital provides insight into how well a company uses its resources to support its operational needs. A higher working capital indicates a more efficient management of short-term resources, suggesting that the company can quickly convert assets into cash to cover liabilities as they come due. In contrast, while aspects of profitability, long-term solvency, and market share are important measures for a business, they do not directly relate to the day-to-day operational efficiency encapsulated by working capital.