

FA Module 7 Interest coverage ratio practice exam questions

covering net revenue, lease expense, interest expense, net income, earnings before interest and taxes, interest coverage ratio, fixed charge coverage ratio

A firm's effective tax rate is 10%, and its financial statements show

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|------------------|-----|
| Net revenue | 851 |
| Lease expense | 25 |
| Interest expense | 14 |
| Net income | 187 |

Question 7.1: Pre-tax income

What is pre-tax income?

Answer 7.1: $187 / (1 - 10\%) = 207.78$

(pre-tax income = net income / (1 – effective tax rate))

Question 7.2: Earnings before interest and taxes

What are earnings before interest and taxes?

Answer 7.2: $207.78 + 14 = 221.78$

(earnings before interest and taxes = pre-tax income + interest expense)

Question 7.3: Interest coverage ratio

What is the interest coverage ratio?

Answer 7.3: $221.78 / 14 = 15.841$

(interest coverage ratio = earnings before interest and taxes / interest expense)

Question 7.4: Fixed charge coverage ratio

What is the fixed charge coverage ratio?

Answer 7.4: $(221.78 + 25) / (14 + 25) = 6.328$

(Fixed charge coverage ratio = (earnings before interest and taxes + other fixed charges) / (interest expense + other fixed charges))