

TECHNICAL INTERVIEW PREPARATION

Finance Technical Interview Guide

Every technical question that matters in investment banking, private equity, and corporate finance interviews - with the answers interviewers are actually grading, taught intuition-first.

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02 Enterprise Value & Equity Value

03 Valuation & DCF Analysis

04 Comparable Company Analysis

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A-C Formulas · Drills · Multiples

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How to use this guide

Read it like a training program, not a novel. The questions are the workout; the chapters are the technique.

This guide contains 306 numbered technical questions, plus six linked diagnostic drills with worked solutions. The study tags indicate editorial practice priority, not measured interview frequency. Use the linked contents and PDF bookmarks to return to a weak topic after each timed attempt.

USING THE EXAMPLES

Numerical cases use stated, simplified assumptions. Explain those assumptions before applying a formula. Study tags suggest practice priorities; they are not a measured database of employer questions.

The answers are written the way a strong candidate would say them out loud: intuition first, then mechanics, in 30-60 seconds. Do not memorize them word for word. Interviewers change one assumption - the tax rate, the payment method, the direction of the transaction - precisely to catch memorizers. Understand why each answer works and you can rebuild it under pressure.

PRACTICE PROTOCOL

Cover the answer, say yours out loud, then compare. Speaking is the test - plenty of candidates who can write a perfect answer freeze when they have to narrate it. If your answer missed the intuition (the "why"), reread the concept section before moving on. Track every question you miss and re-drill misses 48 hours later.

Three reading plans

TIMELINE	PLAN	DAILY LOAD
4+ weeks out	One chapter every 3 days: concepts one day, questions the next, re-drill misses the third. Do Appendix B twice - once mid-prep, once in the final week.	45-60 min

TIMELINE	PLAN	DAILY LOAD
1-2 weeks out	Start with accounting, enterprise value and DCF because later exercises build on them. Allocate the remaining time according to your mistakes and the role. Treat the study tags as suggested priorities, not evidence of question frequency.	2-3 hrs
Interview tomorrow	Appendix A cold, then every "Foundational" question in Chapters 1-3, then the 36 practice problems in Appendix B. Sleep. Do not learn new topics the night before.	3-4 hrs

What interviewers are actually grading

Technical rounds are not trivia contests. The interviewer is testing three things: whether you understand how the pieces of finance connect (accounting to cash flow to value), whether you can think in a structured way under pressure, and whether your answers hold up when they push one level deeper. A candidate who says "I'm not sure, but here's how I'd reason through it" and then reasons well outscores a candidate who recites a memorized paragraph and collapses on the follow-up.

- **Lead with the answer.** "Accretive - here's why" beats a 90-second wind-up. Interviewers reward candidates who commit.
- **Narrate your math.** "Fifty of EBITDA at ten times is 500 of enterprise value." Silence while you compute reads as uncertainty even when you're right.
- **State your assumptions.** Tax rate, payment method, capital structure. Naming assumptions is a senior habit that juniors rarely show.
- **Use the stated inputs.** The 25% tax rate, 4.3% risk-free rate and 5% equity risk premium in practice questions are illustrative. They are not current market quotations. State the valuation date, jurisdiction and source when choosing inputs for real analysis.

COMMON MISTAKE

Advanced modeling practice is less useful if working-capital movements still confuse you. Check the accounting and enterprise-value foundations before adding more complex cases.

Core Technical Topics

Six topics carry every first-round technical interview. Accounting is the language, valuation is the grammar, and deals are the sentences. Master these in order - each chapter assumes the ones before it.

- 01 Accounting Fundamentals - Q.001-Q.042
- 02 Enterprise Value & Equity Value - Q.043-Q.078
- 03 Valuation & DCF Analysis - Q.079-Q.118
- 04 Comparable Company Analysis - Q.119-Q.148
- 05 Mergers & Acquisitions - Q.149-Q.188
- 06 Leveraged Buyouts - Q.189-Q.222

Accounting Fundamentals

The language of business. Every technical question in this book ultimately traces back to these mechanics.

Every finance interview begins here, and most rejections happen here. You must be able to walk through all three financial statements, explain how they connect, and trace any transaction through them without hesitating. Interviewers test this relentlessly because it is the cleanest signal of whether you understand how a business actually works - or whether you memorized a script.

The three financial statements

No single statement tells the whole story. The income statement shows profitability but not cash. The balance sheet shows position but not performance. The cash flow statement shows cash but not the accrual picture. Only together do they describe a business - which is exactly why interviewers ask how they connect.

STATEMENT	WHAT IT SHOWS	KEY QUESTION	TIME FRAME
Income Statement	Profitability on an accrual basis	"Is the company making money?"	A period (quarter/year)
Balance Sheet	What it owns and owes	"What is the financial position?"	A point in time
Cash Flow Statement	Actual cash in and out	"Where is cash coming from and going?"	A period (quarter/year)

The income statement

The income statement flows from revenue at the top to net income at the bottom, on an accrual basis: revenue is recognized when earned and expenses when incurred, regardless of when cash moves. That accrual principle is the source of nearly every "three statement impact" question - the gap between recognition and cash is where the interesting mechanics live.

INCOME STATEMENT STRUCTURE

Revenue - COGS = Gross Profit

Gross Profit - Operating Expenses = Operating Income (EBIT)

EBIT - Interest = Pre-Tax Income (EBT)

EBT - Taxes = Net Income

EBITDA = EBIT + Depreciation + Amortization

Know what lives on each line. **Revenue** is the top line, recognized when earned. **COGS** is the direct cost of what was sold - materials and direct labor for a manufacturer, hosting and support for a software company. **Operating expenses** (SG&A, R&D, marketing) support the business but aren't tied to units sold. **EBIT** is core operating profit, independent of capital structure and tax jurisdiction - which is why so much of valuation is built on it. **Net income** is what's left for shareholders after everyone else - suppliers, employees, lenders, the government - has been paid.

The balance sheet

The balance sheet is a snapshot at a point in time: assets on one side, the claims on those assets - liabilities and equity - on the other. The accounting equation is not a convention, it's an identity: everything the company owns was financed by either borrowing or owners' capital.

THE ACCOUNTING EQUATION

Assets = Liabilities + Shareholders' Equity

ASSETS	LIABILITIES	EQUITY
Cash & equivalents	Accounts payable	Common stock
Accounts receivable	Accrued expenses	Additional paid-in capital
Inventory	Short-term debt	Retained earnings
Prepaid expenses	Long-term debt	Treasury stock (contra)
PP&E, net	Deferred tax liabilities	Accumulated OCI
Goodwill & intangibles	Pension obligations	Non-controlling interest

The cash flow statement

The cash flow statement reconciles accrual net income to the actual change in cash. A company can report profits and still run out of money - revenue booked before cash is collected, inventory bought before it sells. The statement has three sections, and the classification tells you what kind of cash it is.

- **Operating:** starts with net income, adds back non-cash items (D&A, stock-based compensation), and adjusts for working capital changes. This is the section analysts scrutinize - it shows whether the core business generates cash.
- **Investing:** CapEx, acquisitions, asset sales. Persistently negative investing cash flow next to positive operating cash flow is the signature of a healthy, growing company.
- **Financing:** debt issued and repaid, equity raised, buybacks, dividends. Shows how the company funds itself and returns capital.

How the statements link together

Every transaction touches at least two statements, and the important ones touch all three. Three linkages do most of the work, and you should be able to state them in one breath each.

THE THREE LINKAGES

1. Net income → retained earnings. The income statement's bottom line flows into retained earnings on the balance sheet (less any dividends).

2. Net income → cash flow statement. Net income is also the first line of the cash flow statement, which adjusts it to actual cash.

3. Ending cash → balance sheet. The net change in cash at the bottom of the cash flow statement equals the change in the balance sheet cash line. And after everything, $\text{Assets} = \text{Liabilities} + \text{Equity}$ must still hold.

The \$10 depreciation walkthrough

For this three-statement exercise, assume a 25% tax rate, sufficient taxable income and no timing difference between book and cash taxes. Explain each statement in sequence. Actual company tax rates depend on the jurisdiction and facts.

Income statement: depreciation of \$10 reduces EBIT by \$10. At a 25% tax rate you save \$2.50 of taxes, so net income falls by \$7.50. **Cash flow statement:** start with net income down \$7.50, but depreciation is non-cash, so add the \$10 back - cash from operations is up \$2.50. That's the punchline: a non-cash expense increases cash, because it cut your tax bill without costing you anything this period. **Balance sheet:** cash up \$2.50, net PP&E down \$10, so assets are down \$7.50; retained earnings down \$7.50 on the equity side. It balances.

WEAK ANSWER

"Net income goes down, you add back depreciation on the cash flow statement, PP&E goes down on the balance sheet, and it balances."

STRONG ANSWER

"Assuming a 25% tax rate: net income falls \$7.50, because the \$10 expense saves \$2.50 of tax. On the cash flow statement I start \$7.50 lower but add back the full \$10 non-cash charge, so cash is actually up \$2.50 - the depreciation created a tax shield. Balance sheet: cash up \$2.50, PP&E down \$10, assets net down \$7.50, matching retained earnings down \$7.50."

COMMON MISTAKE

Use the tax rate stated in the problem. If none is supplied, state a simplifying assumption, such as 25%, and ask whether to use it. A company's cash tax rate depends on jurisdiction, timing differences and its specific facts; a memorized rate is not a substitute for the prompt.

Working capital & cash flow dynamics

Working capital is the cash tied up in running the business day to day. The level matters less than the *change*: an increase in working capital consumes cash, a decrease releases it. This trips candidates up because it's backwards from intuition - growing receivables means growing sales, but it also means you've delivered goods you haven't been paid for yet.

WORKING CAPITAL

Working Capital = Current Assets - Current Liabilities

Increase in current asset → cash OUT · Decrease → cash IN

Increase in current liability → cash IN · Decrease → cash OUT

ACCOUNT	AN INCREASE MEANS...	CASH IMPACT	WHY
Accounts receivable	More sales on credit	Out	Goods delivered, cash not collected
Inventory	More stock purchased	Out	Cash tied up in unsold goods
Prepaid expenses	Paying ahead	Out	Cash spent before expense hits P&L
Accounts payable	Slower supplier payment	In	Free financing from suppliers
Accrued expenses	Owing more	In	Expense recognized, cash not yet paid
Deferred revenue	Collecting upfront	In	Cash received before revenue earned

MEMORY AID

Current assets are a **use** of cash - you spend cash to hold them. Current liabilities are a **source** - you hold someone else's cash by owing them. Accounts payable is an interest-free loan from your suppliers; deferred revenue is an interest-free loan from your customers.

The cash conversion cycle

The cash conversion cycle measures how many days cash is tied up between paying suppliers and collecting from customers. Shorter is better; negative is a superpower. Amazon and Costco collect from customers weeks before paying suppliers - customers effectively finance the operation for free.

CASH CONVERSION CYCLE

$$CCC = DIO + DSO - DPO$$

$$DIO = 365 \times \text{Inventory} \div \text{COGS} \cdot DSO = 365 \times \text{AR} \div \text{Revenue} \cdot DPO = 365 \times \text{AP} \div \text{COGS}$$

Depreciation, CapEx & D&A

Depreciation spreads the cost of a long-lived asset over the years it produces revenue - the matching principle in action. CapEx is the cash spent to buy those assets. The two are mirror images across time: CapEx is cash out today with no immediate P&L impact; depreciation is P&L expense over the following years with no cash impact. In DCF analysis you add back depreciation (non-cash) and subtract CapEx (real cash) for exactly this reason.

THE PP&E ROLL-FORWARD

Ending Net PP&E = Beginning Net PP&E + CapEx - Depreciation

CapEx = Ending Net PP&E - Beginning Net PP&E + Depreciation

In steady state, depreciation approximates **maintenance CapEx** - the spend needed just to keep the asset base running. Spend above that is **growth CapEx**. When CapEx runs well above depreciation, the company is building; when it runs below for years, the company is either asset-light or quietly under-investing.

- **Straight-line:** $(\text{Cost} - \text{Salvage}) \div \text{Useful Life}$, equal each year. Standard for book purposes.
- **Accelerated (e.g., double-declining balance):** more expense early. Used for tax - it defers taxes and creates deferred tax liabilities (Chapter 8).
- **Units of production:** tied to actual usage; common in mining and manufacturing.

Amortization is the same idea applied to finite-lived intangibles - patents, customer relationships, acquired technology. Goodwill is the exception: under U.S. GAAP it is not amortized, but tested annually for impairment.

Must-know accounting questions

Forty-two questions, ordered from foundational linkage to more involved follow-ups. Master the first ten before progressing.

Q.001 Walk me through the three financial statements. CORE PRACTICE

"The income statement shows profitability over a period on an accrual basis, from revenue down to net income. The balance sheet is a snapshot of what the company owns and owes - assets equal liabilities plus equity. The cash flow statement bridges the two: it starts with net income, adds back non-cash items, adjusts for working capital, then layers in investing and financing activities to explain the change in cash. Net income flows into retained earnings, and ending cash ties to the balance sheet cash line - the three form one connected system." Deliver it in under 45 seconds; the follow-up is always a transaction walkthrough.

WEAK ANSWER

"The income statement shows revenue and expenses, the balance sheet shows assets and liabilities, and the cash flow statement shows cash." (True, but it lists the statements without connecting them - the connections are the entire point of the question.)

STRONG ANSWER

The version above - each statement in one sentence, then the two linkages (net income → retained earnings and cash flow statement → balance sheet cash) stated explicitly. Interviewers listen for the word "flows."

Q.002 How does \$10 of depreciation affect the three statements? CORE PRACTICE

At a 25% tax rate: net income down \$7.50 on the income statement (\$10 expense, \$2.50 tax saved). Cash flow statement: start down \$7.50, add back the \$10 non-cash charge - cash from operations up \$2.50. Balance sheet: cash up \$2.50, net PP&E down \$10, assets net down \$7.50; retained earnings down \$7.50. The tax shield is the insight: a non-cash expense *increases* cash.

Q.003 A company collects \$100 of receivables. Three-statement impact? CORE PRACTICE

No income statement impact - revenue was recognized when the sale was made. Cash flow statement: the decrease in accounts receivable is a \$100 source of cash in operations. Balance sheet: cash up \$100, receivables down \$100 - one asset swapped for another, totals unchanged. This tests whether you separate revenue recognition from cash collection.

Q.004 What's the difference between cash-based and accrual accounting? CORE PRACTICE

Cash accounting records revenue when cash arrives and expenses when cash leaves. Accrual accounting - required under GAAP and IFRS - records revenue when earned and expenses when incurred, matching costs to the revenue they generate. Accrual gives a truer picture of performance; the cost is that reported profit and actual cash diverge, which is exactly the gap the cash flow statement exists to explain.

Q.005 A company buys \$100 of equipment with cash. Walk me through the statements. CORE PRACTICE

At purchase: no income statement impact - CapEx is capitalized, not expensed. Cash flow statement: \$100 outflow in investing. Balance sheet: PP&E up \$100, cash down \$100 - total assets unchanged. Then over the asset's life, depreciation runs the Q.002 mechanics each year: expense on the income statement, add-back on the cash flow statement, PP&E and retained earnings stepping down together.

Q.006 Same equipment, but financed entirely with debt. What changes? CORE PRACTICE

If the company borrows \$100 cash and immediately buys equipment for \$100, PP&E and debt each rise \$100; net cash is unchanged. The cash flow statement records \$100 financing inflow and \$100 investing outflow. If a lender instead directly finances a noncash asset acquisition, disclose the noncash investing/financing transaction rather than inventing cash flows. Later depreciation and cash interest reduce earnings; only depreciation is added back in the indirect cash flow statement.

Q.007 How does an inventory write-down flow through the statements? CORE PRACTICE

Income statement: the write-down (usually within COGS) reduces pre-tax income; at 25% tax, a \$100 write-down cuts net income by \$75. Cash flow statement: net income down \$75, but the write-down is non-cash - add back \$100, so operating cash flow is up \$25 (the tax shield). Balance sheet: inventory down \$100, cash up \$25, retained earnings down \$75. Same skeleton as depreciation - most non-cash charge questions are.

Q.008 **What happens when a company writes off bad debt?** FOLLOW-UP

Under the allowance method, the P&L hit happens when the allowance is created: bad debt expense reduces net income, and the allowance (a contra-asset) reduces net receivables. When a specific account is later written off, allowance and gross receivables fall together - no new P&L impact. The rarely-used direct write-off method expenses at write-off, which violates matching. Mention the two methods; it signals real accounting fluency.

Q.009 **What's the difference between gross profit and net income?** FOLLOW-UP

Gross profit is revenue minus COGS - it isolates production economics and pricing power. Net income is what remains after *everything*: operating expenses, interest, taxes. A company can have 70% gross margins and still lose money if it overspends on sales and R&D - common in early-stage software. Always say which margin you mean; the gap between them is where the story of the business lives.

Q.010 **Why can a profitable company go bankrupt?** CORE PRACTICE

Because profit is accrual and bills are paid in cash. A company growing fast books revenue before collecting it, builds inventory ahead of sales, and pays suppliers and payroll now - working capital consumes cash faster than earnings generate it. Add a debt maturity it can't refinance, and a "profitable" company fails. This is why lenders and PE firms underwrite cash flow, not net income.

Q.011 **What is working capital, and why does its change matter more than its level?** CORE PRACTICE

Working capital is current assets minus current liabilities - the cash tied up in daily operations. The level tells you liquidity; the *change* tells you cash flow. If receivables and inventory grow faster than payables, the business consumes cash as it grows, and that consumption comes straight out of free cash flow. In a DCF or LBO model, the change in working capital line is where growth quietly eats cash.

Q.012 **Accounts receivable increases \$50. What happens to cash?** CORE PRACTICE

Cash from operations falls by \$50. You recognized revenue and booked profit, but the customer hasn't paid - so on the cash flow statement, the increase in receivables is subtracted from net income. The general rule: an increase in a current asset uses cash; an increase in a current liability provides it.

Q.013 **A customer prepays \$120 for a one-year subscription. Walk it through.** CORE PRACTICE

At collection: no revenue yet - you haven't delivered. Cash up \$120, deferred revenue (a liability) up \$120; the cash flow statement shows \$120 of operating inflow. Each month, you recognize \$10 of revenue and deferred revenue steps down - no cash impact, since the cash came upfront. This is why subscription businesses show operating cash flow running ahead of revenue while growing: customers fund them in advance.

Q.014 **What is the cash conversion cycle?** FOLLOW-UP

CCC = days inventory outstanding + days sales outstanding - days payable outstanding: how many days cash sits tied up between paying suppliers and collecting from customers. A retailer at $30 + 5 - 45$ has a CCC of -10 days - customers and suppliers finance the business. Negative CCC means growth

generates working capital cash instead of consuming it, which is a genuine competitive weapon (Amazon, Costco).

Q.015 How do you calculate days sales outstanding, and what does it tell you? FOLLOW-UP

DSO = accounts receivable ÷ revenue × 365. It measures how quickly customers pay - 35 days is typical for B2B; a rising trend flags collection problems, loosening credit standards, or channel stuffing. Compare against peers and against the company's own history, and check it whenever revenue growth looks suspiciously strong.

Q.016 What's the difference between CapEx and an operating expense? CORE PRACTICE

An operating expense is consumed within the period and expensed immediately. CapEx buys an asset that produces benefits over multiple years, so it's capitalized to the balance sheet and expensed gradually through depreciation - the matching principle. The judgment call matters: aggressive capitalization (of software development, say) inflates current earnings by pushing expense into the future. WorldCom's fraud was exactly this.

Q.017 How do you calculate CapEx if it isn't disclosed? FOLLOW-UP

Use the PP&E roll-forward: CapEx = ending net PP&E – beginning net PP&E + depreciation. Intuition: PP&E rises by what you buy and falls by what you depreciate, so if you know the endpoints and the depreciation, spending is the plug. Adjust for acquisitions or asset sales if the balance sheet moved for other reasons.

Q.018 What's the difference between maintenance and growth CapEx? FOLLOW-UP

Maintenance CapEx keeps the existing asset base running - roughly equal to depreciation in steady state. Growth CapEx expands capacity. The split matters for valuation: a company spending 2x depreciation is investing for growth, so weak current free cash flow may be a choice, not a problem. Companies rarely disclose the split; depreciation is the standard proxy for the maintenance piece.

Q.019 What is amortization, and how is goodwill treated differently? FOLLOW-UP

Amortization is depreciation for finite-lived intangibles - patents, customer lists, acquired technology - a non-cash expense over the asset's useful life. Goodwill is the exception: under U.S. GAAP it isn't amortized but is tested annually for impairment. If the reporting unit's fair value falls below carrying value, goodwill is written down through the income statement - a one-time, non-cash charge that usually admits the company overpaid for an acquisition.

Q.020 Explain LIFO vs FIFO. Which shows higher profit when prices rise? FOLLOW-UP

FIFO expenses the oldest (cheapest) inventory first, so in inflation it shows lower COGS and *higher* profit - and a higher tax bill. LIFO expenses the newest (most expensive) units first: higher COGS, lower profit, lower taxes, and a balance sheet carrying stale inventory costs. LIFO is permitted under U.S. GAAP only - IFRS bans it. When comparing companies, check the footnotes and use the LIFO reserve to adjust.

Q.021 What is EBITDA, and what are its limitations? CORE PRACTICE

EBITDA is earnings before interest, taxes, depreciation, and amortization - a rough proxy for operating cash generation that is capital-structure and tax neutral, which is why it anchors EV multiples and leverage ratios. Its limits: it ignores CapEx (fatal for capital-intensive businesses), ignores working capital swings, and is a non-GAAP figure companies love to "adjust." As Buffett puts it - does management think the tooth fairy pays for CapEx? Use it, but know what it hides.

Q.022 How do you calculate free cash flow from the financial statements? CORE PRACTICE

Simplest version: cash flow from operations minus CapEx. The build-up version used in DCFs: $EBIT \times (1 - \text{tax rate}) + D\&A - \text{CapEx} - \text{increase in working capital}$. Free cash flow is the cash left for capital providers after the business has paid for its own operations and reinvestment - the number every valuation ultimately discounts. Negative FCF isn't automatically bad; it depends whether the cash is funding growth or covering losses.

Q.023 What is the current ratio, and what does it tell you? FOLLOW-UP

Current assets $\div$ current liabilities - a quick solvency check on whether near-term assets cover near-term obligations. Above 1.0x is conventionally "safe," but context rules: grocers run below 1.0x comfortably because inventory turns to cash in days, while a ratio far above 2.0x may just mean capital sitting idle. Always benchmark against the industry, not the textbook threshold.

Q.024 What is the quick ratio, and when is it more useful than the current ratio? FOLLOW-UP

$(\text{Current assets} - \text{inventory}) \div \text{current liabilities}$ - the "acid test." It strips out inventory, the least liquid current asset, so it's the better measure when inventory is slow-moving or at risk of markdown: fashion retail, autos, anything cyclical. A company with a healthy current ratio but a weak quick ratio is one markdown cycle away from a liquidity problem.

Q.025 How do you calculate inventory turnover, and what does it signal? FOLLOW-UP

$\text{COGS} \div \text{average inventory}$; days inventory outstanding is $365 \div \text{turnover}$. High turnover means efficient inventory management - or stockouts; low turnover means slow-moving goods and markdown risk. Trend matters more than level: inventory growing faster than revenue for two straight quarters is one of the most reliable early warnings of a demand problem.

Q.026 What happens when a company pays down \$100 of accounts payable? FOLLOW-UP

No income statement impact - the expense was recognized when incurred. Cash flow statement: the decrease in payables is a \$100 use of operating cash. Balance sheet: cash down \$100, payables down \$100; assets and liabilities shrink together, equity untouched. You're simply settling an obligation already on the books.

Q.027 How do dividends affect the three statements? CORE PRACTICE

Dividends are a distribution of profit, not an expense - the income statement is untouched. When declared: retained earnings down, dividends payable (a liability) up. When paid: cash and the payable both fall, and the cash flow statement shows an outflow in *financing*. Candidates who run dividends through the income statement fail this instantly.

Q.028 What is retained earnings, and can it be negative? FOLLOW-UP

Retained earnings is cumulative net income minus cumulative dividends - the bridge account between the income statement and the balance sheet. It can absolutely be negative (an "accumulated deficit"): either the company has lost money historically, or it has returned more capital than it earned. Big buyback programs can push even excellent businesses into negative retained earnings - look at the actual driver before judging.

Q.029 How does a share buyback affect the statements? CORE PRACTICE

No income statement impact at repurchase. Balance sheet: cash down, treasury stock (a contra-equity account) up - so total equity falls. Cash flow statement: outflow in financing. The second-order effect is the one interviewers want: fewer shares outstanding raises EPS, which is why buybacks can lift per-share metrics even with flat net income. Book value per share falls if shares are bought above book value.

Q.030 What is treasury stock? FOLLOW-UP

Shares the company has repurchased and holds - recorded at cost as a contra-equity account that reduces total shareholders' equity. Treasury shares carry no votes and receive no dividends, and they're excluded from EPS share counts. If reissued above cost, the excess goes to additional paid-in capital, not to income - companies can't book profits trading their own stock.

Q.031 How does a stock split affect the financial statements? FOLLOW-UP

Economically, it doesn't. A 2-for-1 split doubles share count and halves per-share price and par value; total equity, net income, and cash are all unchanged, and EPS is restated for all periods. There's no cash flow. The only real effects are optical - a lower per-share price and sometimes broader retail ownership.

Q.032 What is accumulated other comprehensive income (AOCI)? FOLLOW-UP

An equity account for gains and losses that bypass the income statement: foreign currency translation adjustments, unrealized gains/losses on certain securities and cash-flow hedges, and pension remeasurements. These items change equity without touching net income, and some "recycle" into earnings when realized - sell the foreign subsidiary and the cumulative translation adjustment flows through the P&L at once.

Q.033 How do stock options affect the financial statements? CORE PRACTICE

The grant-date fair value is expensed over the vesting period as stock-based compensation - reducing net income - with the offset building additional paid-in capital, so it's non-cash and added back on the cash flow statement. At exercise, the company receives the strike price in cash and issues shares. The real cost is dilution: in-the-money options raise the diluted share count via the treasury stock method (Chapter 2), and serious analysis treats SBC as a true economic expense (Chapter 8).

Q.034 What is the interest coverage ratio? FOLLOW-UP

$\text{EBIT} \div \text{interest expense}$ ($\text{EBITDA} \div \text{interest}$ is the looser credit-market variant): how many times operating profit covers the interest bill. Below ~2x lenders get nervous; below 1x the company can't service debt from operations. It's a core covenant metric and the fastest single check on whether a capital structure is sustainable - especially relevant with rates meaningfully higher than the 2010s.

Q.035 What's the difference between operating leverage and financial leverage? CORE PRACTICE

Operating leverage comes from fixed costs in the cost structure: high fixed costs mean small revenue changes swing operating income violently - think airlines or semiconductor fabs. Financial leverage comes from debt in the capital structure: interest is a fixed claim, so swings in operating income hit equity holders amplified. Both are magnifiers, and they compound - a high-fixed-cost business with heavy debt is the most fragile combination in a downturn.

Q.036 How does revenue recognition work for long-term contracts? FOLLOW-UP

Under ASC 606, revenue is recognized as performance obligations are satisfied. For multi-year construction or defense contracts, that usually means over time, measured by progress - typically costs incurred as a percentage of total estimated costs. The risk is estimate revisions: raise the total cost estimate and previously booked margin reverses through current earnings. Contract accounting is a recurring home of earnings surprises.

Q.037 What is an asset impairment, and how does it flow through the statements? FOLLOW-UP

When an asset's carrying value exceeds its recoverable value, it's written down. Income statement: impairment charge cuts pre-tax income. Cash flow statement: non-cash - added back, so operating cash flow is barely touched. Balance sheet: asset down, retained earnings down. Goodwill impairments can never be reversed under GAAP. Markets often shrug at impairments precisely because they're non-cash confessions of past mistakes, not new cash losses.

Q.038 How does foreign currency translation affect the statements? FOLLOW-UP

For a foreign subsidiary, balance sheet items translate at the period-end rate and income statement items at the average rate for the period. The mismatch lands in the cumulative translation adjustment within AOCI - equity moves, net income doesn't. Transaction gains and losses (a payable in another currency, say) do hit net income immediately. Distinguish the two and you're ahead of most candidates.

Q.039 **How do you calculate return on equity, and what drives it?** CORE PRACTICE

ROE = net income ÷ average shareholders' equity. DuPont decomposition shows the three levers: ROE = net margin × asset turnover × equity multiplier - profitability, efficiency, leverage. That last term is the catch: a mediocre business can print a high ROE simply by piling on debt. Always ask *which* lever is doing the work before applauding the number.

Q.040 **What's the difference between ROE and ROIC?** FOLLOW-UP

ROE measures returns to equity holders and is flattered by leverage. ROIC = NOPAT ÷ invested capital (debt plus equity, less cash) measures the return on *all* capital in the business, regardless of how it's financed. ROIC against WACC is the fundamental value-creation test: a company earning 15% ROIC against a 9% WACC creates value with every dollar it reinvests; one earning 6% destroys it - growth just accelerates the destruction.

Q.041 **What's the difference between book value and market value of equity?** FOLLOW-UP

Book value is the accounting residual - assets minus liabilities, built from historical cost. Market value is share price times shares outstanding - the market's forward-looking estimate of what future cash flows are worth. Most quality companies trade far above book because their real assets (brands, software, networks, people) never appear on the balance sheet. Book value stays central mainly for banks and insurers, where assets are financial and marked closer to reality.

Q.042 **What is the matching principle, and why does it matter?** FOLLOW-UP

Expenses should be recognized in the same period as the revenue they help generate. It's the reason inventory sits on the balance sheet until sold (then becomes COGS), and the reason CapEx is depreciated over years instead of expensed at once. Nearly every accrual on the balance sheet - prepaid expenses, deferred revenue, accrued liabilities - exists to enforce matching. Understand it and half of accounting stops being memorization.

STRONG SIGNAL

On any three-statement question, end with the balance check: "assets down \$7.50, equity down \$7.50 - it ties." Interviewers hear hundreds of answers that trail off; closing the loop unprompted marks you as someone who finishes the job.