

Certified Transaction Advisor



Association of Professional Merger & Acquisition Advisors

Exam Study Guide

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I. Program Overview

APMAA Members are eligible to earn the prestigious Certified Transaction Advisor (CTA) designation. The CTA designation can be earned entirely online and takes advantage of the APMAA's Online University educational and testing system. This secure system is based on the same software used by many leading university across the country.

Earning Certification is an excellent opportunity for business brokers and intermediaries to demonstrate their professional expertise, commitment to high ethical standards, and dedication to our profession. Additionally, the CTA designation is a significant step in assisting the general public in evaluating your professional credentials.

This Study Guide is intended to provide individuals and overview of the material that is on the CTA exam. It is not intended to be a "teaching" guide or a replacement for in-depth courses that are available to individuals in subjects such as accounting, finance, and valuation.

There are five main topics that are on the CTA exam. These topics embody a large amount of the technical knowledge that the APMAA believes is needed for a transaction advisor to provide competent services to clients.

II. Program Regulations

CTA Designation Requirements:

1. Individual must be a member in good standing with the APMAA.
2. Individual must pledge to uphold the APMAA's Code of Ethics.
3. Individual must pass the online CTA Exam with a score of 75% or better.
It is the candidate's responsibility to prepare for the exam.
4. By taking the online exam, Members are agreeing to all CTA Regulations.

CTA Exam Procedure:

1. Register online at: [APMAA's Online University](#)
2. Establish a user name/password for the online testing system.
3. Pay for the exam via credit card.
4. You will need an enrollment key to enter the test. **The Enrollment Key can be found on the member-only portion of the APMAA website.**
5. The test must be taken within 7 days of registration.
6. 4 hours to complete the exam.
7. Graded on a Pass/Fail scale with a 75% needed to pass.

Identification

The APMAA will issues a CTA Certificate to individuals passing the CTA exam and meeting all other CTA requirements. Members receiving the CTA designation are granted a limited license to include the designation initials "CTA" or the words

"Certified Transaction Advisor" on their marketing material (including business cards, letterhead, websites, etc.).

CTA Designation Maintenance Requirements:

1. Individuals must maintain an active membership, in good standing, with the APMAA.
2. Each CTA will be required to participate in continuing education activities as established by the Certification Committee.
3. All continuing education activities will be available on-line. Classes provided by third-parties, containing similar content, may be substituted for APMAA content (prior approval suggested).

Termination and Revocation of Certification:

The CTA designation is automatically terminated for the following circumstances:

1. Failure to maintain an active membership in the APMAA.
2. Loss of good standing membership in the Association.
3. Failure to complete any CTA Designation Maintenance Requirements.

The CTI designation may be revoked by the APMAA for a violation of the Association's bylaws, rules, regulations, or Code of Ethics.

Forfeiture

Any individual who has their CTA designation automatically terminated or revoked by the Association, agrees to immediately stop using and/or displaying the words Certified Transaction Advisor or the initial "CTA" on any marketing or promotional material (including business cards, letterhead, websites, certificates, etc.). Additionally, they may not make any printed, electronic, or verbal references to the CTA designation, and their former status of being a CTA, when promoting their services, skill, or experience.

III.Exam Composition

The exam is a 100 question test consisting of 80 multiple choice and 20 true/false questions. People taking the exam are given four hours to complete it – which should be more than ample time. A grade of 75% or better is needed to pass the exam which is administered online. Exam grades are provided immediately after the exam and include the option to review each question along with the correct answer. Most questions also have an explanation for the correct answer.

Questions taken from a "test bank" and will vary on each exam. Topics include:

1. Professional Standards
2. Contracts
3. Legal & Regulatory Issues
4. Accounting & Finance
5. Valuation

IV. Exam Preparation

The exam is intended to cover a “body of knowledge” that a proficient business broker would possess. An experienced broker can pass the test without extensive study. But, any person taking the exam would benefit by reviewing this guide and possible outside material to firm up areas where they may not have as much experience or formal training.

The study guide will cover each section of the exam, and review major topics, concepts, and terms that an individual should know.

V. Professional Standards

Many of the “technical” areas covered in the CTA exam are well documented by third-parties; such as basic accounting and valuation.

The Professional Standards section of the exam is a compilation of material gathered through research and recommendations; i.e. best practices from leading business brokers across the United States. It provides facts for the business brokers and dispels common myths about our industry and how to operate successfully.

The APMAA believes that every Business Broker should understand the dynamics of the industry they work in and how their practice fits in. The APMAA has classified Professional Standards into four categories:

1. General Industry Knowledge
2. Best Practices
3. SBA Loans
4. Ethics

General Industry Knowledge

Below are the concepts and terms that exam candidates should know:

- Basic services provided by business brokers
- Difference between tangible and intangible services provided by business brokers
- Key benefits of services to clients
- Contents of an Information Memorandum
- Industry size
- Three core types of companies in the industry and their characteristics
 - Business Brokers
 - M&A Advisors
 - Full Service Investment Banks
- Estimated number of business brokers in the U.S.
- Estimated number of businesses that actually sell
- Understanding on the number and size of businesses in the U.S.; i.e. how many small businesses are there? (U.S. Census Bureau)
- Overview of target customer profile
- Length of time for an average small business sale
- Terms:

- Lehman Formula
- LOI
- Asset versus stock sale

Best Practices

Below are the concepts and terms that exam candidates should know:

- Contents of an Information Memorandum
- Major components of a Letter-of-intent
- What contracts a business broker should and should not prepare
- Standard Seller Discretionary Cash Flow adjustments
- When to present offers to clients
- Handling Deposits
- How to handle franchise transfer fees
- Using earn-outs to bridge valuation differences
- Terms:
 - Information Memorandum
 - Confidential Business Review
 - Seller Discretionary Cash Flow
 - Earn-out

SBA Loans

Information on SBA loans can be found at the SBA website. Below are the concepts and terms that exam candidates should know:

- Difference between 7(a), 504, and other loan programs
- How interest rates are determined on SBA backed loans
- What is needed to qualify for a loan
- Cash deposit requirements
- SBA loan size limits
- Current business “goodwill” guidelines in regards to loan qualification and approval

Ethics

Candidate should know the difference between legal requirements and ethical requirements. The APMAA requires each member to act in accordance with a strict code of ethics designed to promote the highest level of professionalism in the business brokerage and merger & acquisition industry.

All APMAA active members agree to abide by the following Code of Ethics:

1. To promote actions that build trust with our customers, regulatory authorities, and the general public.

2. To protect the confidential nature of each individual customer's business records and to not disclose information except as permitted by law or regulation.
3. To observe all laws and regulations governing their services.
4. To deal honestly and fairly with clients and all concerned.
5. To act with skill, care, and diligence in any transaction.
6. To ensure that advertising is accurate and truthful, and free of any device which could create an erroneous impression or otherwise be contrary to the public interest.
7. To answer all proper inquiries to the best of their ability and satisfy all reasonable complaints.
8. To act in good faith. To follow good business practices, and to represent available services and products accurately.
9. To respect and support APMAA members.
10. To uphold the work and interests of the APMAA and avoid conduct which may bring discredit to the APMAA and its members.

Ethical questions on the exam are situation in nature.

VI. Contracts

Contracts play an integral role in the deal process. Every transaction advisor should have a firm grasp of the type of contracts involved and the impact on the basic terms in each contract. Below are the concepts and terms that exam candidates should know:

- Types of Listing Agreements; exclusive versus non-exclusive, etc.
- Difference between consideration and sale price
- Fee structuring
- Procurement clause
- Major components of a Letter-of-Intent
 - a. Price
 - b. Terms
 - c. financing contingency
 - d. Exclusivity clauses, etc.
- Major components Purchase Agreements and what they mean:
 - a. representations and warranties
 - b. pre-closing covenants
 - typical negative covenants
 - typical affirmative covenants

- c. conditions precedent to closing
- d. indemnification
- Terms:
 - Retainer
 - Commitment fee
 - Success fee
 - Commission
 - Listing Agreement
 - Engagement Letter
 - Consideration
 - Sale Price
 - Transaction broker
 - Fiduciary
 - Dual agency
 - Tail clause
 - No-shop clause
 - Indemnification basket
 - Tipping clause
 - Survival period

VII. Legal & Regulatory Issues

A Business Broker is generally defined as a person who assists individuals in selling or buying a small business. In general, the field is not highly regulated, but the wide range of activities that business brokers engage in can subject them to many national and state regulations.

Below are the concepts and terms that exam candidates should know:

- U.S. Federal Regulations governing business broker activities
- State regulations governing business broker activities
- Governing regulatory bodies at the state and federal levels
- How the legal structure of a transaction affects licensure requirements
- The roles of the SEC and FINRA
- The three key areas the SEC looks at to determine if someone's activities require them to register as a broker-dealer
- Significant No action letters from the SEC and their impact on business brokerage
- When a real estate license is required to be a business broker
- The difference between different legal entities (sole proprietorship, corporation, etc.)
- The difference between employees and independent contractors
- Terms
 - SEC
 - FINRA
 - SRO
 - Finder Fee

- No action letter
- “S” corporation
- “C” corporation
- LLC
- Partnership
- Ostensible partnership
- Common stock
- Preferred stock
- Independent contractor
- Employee

Supplemental Study Material

2010 APMAA Report on Legal & Regulatory Issues

This eighteen page report is available on the APMAA Member only website. It provides a good overview and analysis of Federal and State regulations. It can be downloaded from the APMAA member-only website. On the website, go to the APMAA Insider’s Guide - Regulatory Center to download the report.

VIII. Accounting & Finance

The ability to read financial statements and tax returns is a crucial skill for a transaction advisor to have. Although a good business broker does not need to be able to prepare accounting records or tax returns, they should be able to read and interpret the data presented. Below are the concepts and terms that exam candidates should know:

Financial Statements

- Balance sheet
- Income Statement
- Cash Flow Statement
- The purpose of and how to recast financial statements
- How to calculate operating income, net income, and cash flow
- Ratio Analysis
- How to calculate basic financial metrics such as DSO and Inventory Turns
- Terms
 - Current Ratio
 - DSO
 - Net operating income
 - EBITDA
 - SDCF

Taxes

- Difference between ordinary income and capital gains tax
- Difference between cash and accrual taxes
- Taxable income

- Terms
 - Capital gains tax
 - Ordinary income tax
 - Double taxation

Accounting Basics

- Difference between cash and accrual accounting
- What does double entry accounting mean?
- Terms
 - Accounting equation (Assets = Liabilities + Equity)
 - Assets
 - Prepaid asset
 - Liabilities
 - Owner's equity
 - Capital expenditure
 - AR
 - Long term liability
 - Short term liability
 - GAAP
 - General ledger

Supplemental Study Material

Several excellent books are available for free on the APMAA website (member-only section). On the website, go to the APMAA Insider's Guide – Education and Reference to download the books. These books can provide a good foundation for those who have not taken formal accounting or finance classes.

The Accounting Cycle

Covers financial versus managerial accounting, the accounting equation, the impact of transactions on the accounting equation, basic financial statements, etc.

Using Accounting Information

The second half of the book, Part 2 - Financial Analysis and Statement of Cash Flows is excellent. It has an overview of basic ratio analysis and also covers how to understand and prepare a cash flow analysis for a business.

IX. Valuation

Valuing and pricing a business for sale is an essential skill for successful business brokers. Even if the business broker is not preparing a formal valuation report themselves, they should know how to calculate basic business valuations based on several industry acceptable methods and understand the theory behind the various valuation techniques.

Candidates should become familiar with either a financial calculator or Excel which makes calculating present values and discounted cash flows much easier.

Below are the concepts and terms that exam candidates should know:

- Income, Market, and Asset valuation theory and the strength and weakness of each approach
- How to calculate a basic business valuation based on different valuation methodologies including:
 - Income Capitalization (Capitalized excess earnings)
 - Discounted Cash Flow
 - Comparable Sales
- How U.S. Treasury yields effect business valuation
- How terminal value assumptions effects business valuation
- Compound versus simple interest
- How to calculate Net Present Value
- How to use comparable sales figures
- Terms
 - Goodwill
 - Risk free rate of return
 - Book value
 - IRR
 - NPV
 - Present Value
 - Fair Market Value
 - Price
 - Equity discount rate
 - Debt discount rate
 - Discount rate
 - Risk premium
 - WACC
 - Net operating income
 - Terminal value
 - Perpetuity
 - Gordon's growth model

Supplemental Study Material

On the website, go to the APMAA Insider's Guide – Education and Reference to download the book.

Corporate Finance

Pay particular attention to Chapter 3, Present Value and Opportunity Cost of Capital

X. Glossary of Common Terms

*Note this glossary is not intended to be all inclusive.

Asset sale – a transaction whereby the business assets are sold and transferred from the seller to the buyer and the seller retains the corporate stock. Typically, the seller will also retain all preclosing liabilities and/or be required to pay off any long-term debt at closing. Transaction structure can vary based on specific circumstances where the seller may or may not purchase accounts receivable and assume current liabilities. This report assumes that normal “working capital” is included in the business sales value since excluding it would require a potential purchaser to infuse cash into the business directly after closing (which would result in an offsetting reducing of price).

CAPEX – is an abbreviation for capital expenditures.

Day on market – typically refers to the total days from when a company is initially listed for sale until a transaction closes.

Discount rate – the rate, expressed as a percentage that cash flows are discounted at in financial calculations such as net present value calculations.

DSO – is used to assess accounts receivable management. It indicates the average length of time it takes a business to collect on sales. It is calculated by dividing receivables by average sales per day (this report assumes a 365 day for average sales calculations).

EBIT – Earnings before interest and taxes (also referred to as Net Operating Income). It reflects the earnings of the business from operations exclusive of financing and taxes.

EBITDA – Earnings before interest, taxes, depreciation, and amortization. It is commonly used as a quick approximation of a company’s real cash flow (excluding working capital and capex) and hence is one of the widely used numbers for applying “multiples” to calculate a business value.

Equity Discount Rate – the discount rate applied to a specific business. It is normally calculated as a “build-up” from a risk free rate and adjusted for the specific business circumstances. It is used to approximate the required rate of return of an equity investment in the business.

Fair market value – is the price, in cash or equivalent, that a willing buyer could reasonably be expected to pay, and a willing seller could reasonably be expected to accept, if the business were promoted for sale on the open market for a reasonable period of time, and both buyer and seller having full knowledge of pertinent facts of the business and neither under the compulsion to conclude a transaction.

FF&E - furniture, fixtures, and equipment.

Free cash flow – (also called Net Cash Flow) is the sum of net income plus non cash adjustments. FCF represents how much “cash” the business generates after taxes rather than accounting profits. This generally differs from accounting profits because some of the revenues and expenses listed on a typical income statement are not actual cash transactions during the year or are not reported on the income states; i.e. depreciation and capital expenditures. For private company’s, adjustments must also be made for non-business related expenses. In this report, Net Cash Flow is calculated as follows:

1. Net income (after taxes and adjustments for any expenses not related to the business)
2. Plus depreciation
3. Plus amortization
4. Changes in working capital
5. Less capital expenditures

Net Income – income after accounting for all expenses associated with the business (including taxes).

Net Operating Income – Earnings before interest and taxes (also referred to as EBIT). It reflects the earnings of the business from operations exclusive of financing and taxes.

Net Present Value – the expected value of a stream of future cash flows discounted back at an appropriate rate or cost of capital.

Sellers Discretionary Cash Flow

SDCF represents a recasting of the Company’s earnings to reflect expenses associated with the current ownership which may or may not be incurred under new ownership. In this report, SDCF is calculated as follows:

1. Net Operating Income (income before taxes and interest, also known as EBIT)
2. Plus reported compensation for a single working owner
3. Plus above-market rate reported compensation for any other working owners
4. Plus depreciation
5. Plus amortization
6. Plus any non-recurring expenses
7. Plus expenses not related to operating the business

SIC – Standard Industrial Classification.

Weighted Average Cost of Capital (WACC) – the weighted average of the after-tax component cost of capital (debt, preferred stock, and common equity). Each weight is proportionate to that type of capital in the structure. In this report, Bridge typically assumes a 100% common equity scenario and thus the WACC is equal to the Equity discount rate (equity cost of capital)

Working Capital – current assets less current liabilities.

XI. Common Formulas Reference Guide

Simple Interest

$$FV = P + I \times N$$

Where:

FV is the future value of the amount including the principal

P is the principal (loan) amount

I is the interest rate

N is the duration of the loan, using number of periods

Compound Interest

$$FV = P(1 + i)^n$$

Where:

FV is the future value amount including the principal

P is the principal amount

i is the rate of interest per period

n is the number of periods

Notes:

Make sure your “periods” match. As an example, if 7% interest was compounded monthly for five years, $i = .07 / 12$ and $n = 5 * 12$ or

$i = .5833\%$ (the interest rate per period)

$n = 60$ (the total number of periods that is compounded)

Common Financial Ratios

Liquidity and Debt Service Ratios

Ratio	Formula	Measure
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Measure of liquidity; ability to meet near term obligations.
Quick Ratio	$\frac{\text{Cash} + \text{Short Term Investment} + \text{AR}}{\text{Current Liabilities}}$	Narrow measure of liquidity and a firms ability to meet near term obligations.
Debt to Total Assets	$\frac{\text{Total Debt}}{\text{Total Assets}}$	Percentage of assets financed by debt.
Debt to Total Equity	$\frac{\text{Total Debt}}{\text{Total Equity}}$	Proportion of financing that is debt related.
Times Interest Earned	$\frac{\text{Income Before Income Taxes and Interest}}{\text{Interest Charges}}$	Firm's ability to meet interest obligations.

Effeciency and Turnover Ratios

Ratio	Formula	Measure
Days Sales Outstanding (DSO)	$\frac{\text{Accounts Receivable Balance}}{(\text{Annual Sales} / 365)}$	Average collection time. Can be calculated for the year (365), quarter, or any other period.
Inventory Turnover	$\frac{\text{Cost of goods sold}}{\text{Average Inventory}}$	Frequency of inventory rotation; how fast a firm sells inventory.
Days in Inventory	$\frac{365}{\text{Inventory Turnover}}$	Average number of days items remain in inventory before being sold.

Profitability Ratios

Ratio	Formula	Measure
Net Profit on Sales	$\frac{\text{Net Income}}{\text{Net Sales}}$	Profitability on sales for comparision and trend analysis.
Gross Profit Margin	$\frac{\text{Gross Profit}}{\text{Net Sales}}$	Gross profit rate for comparision and trend analysis.
Return on Assets	$\frac{\text{Net Income} + \text{Interest Expenes net of income tax savings}}{\text{Average Assets}}$	Measures firm performance in using assets to generate eranings independent of how the assets were financed.
Return on Equity	$\frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Average Common Equity}}$	Firm's performance in using and financing assets to generate eranings.

Equity Discount Rate

Equity Discount Rate Calculation	
Discount Rate Build-up	Basis
Current Risk Free Rate	U.S. Treasury Bond Yield
+ Premium for Equity Investment	Risk Premium for investing in public company stock
+ Premium for Small Company Size	Risk Premium for investing in a small company.
+ <u>Company Specific Risk Premium</u>	Company & Industry specific risk premium *
= Equity Discount Rate	

* Calculated various ways. Sometime called Owner Operator Risk premium.

Income Capitalization Valuation Method

Income Capitalization Method	
Business Value =	$\frac{\text{Net Income}}{\text{Capitalization rate}}$
Where	Capitalization Rate = Equity Discount rate - Long Term Growth Rate of Cash Flow
Notes: Business value may need to be adjusted based on working capital adjustments and/or Excess inventory amounts above normal working levels.	

Capitalized Excess Earnings

Capitalized Excess Earnings Method

Business Value = Business Good will Value + Net Tangible Asset Value

Where

Business Goodwill = Excess earnings / Capitalization Rate

Capitalization Rate = Equity Discount rate - Long Term Growth Rate of Cash Flow

Excess Earnings = Business Free Cash Flow - (Net Tangible Assets * Safe Return Rate)

Notes: Business value may need to be adjusted based on working capital adjustments and/or Excess inventory amounts above normal working levels.

Capitalized Excess Earnings Example

Business Free Cash Flow		150,000
Net Tangible Assets	50,000	
Safe Return	<u>3.8%</u>	
- Safe return on assets		(1,900)
= Business excess earnings		<u>148,100</u>
X Capitalization rate		25.0%
= Value of excess earnings (goodwill)		592,400
+ Value of net tangible assets		<u>50,000</u>
Estimated Business Value		642,400

Calculating NPV with Excel

	A	B	C	D	E	F	G	H	I
1									
2				<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	
3				5,000	5,000	5,000	5,000	5,000	
4		Discount Rate	12%						
5		NPV =	18,024						
6									
7		Where NPV Formula =							
8			=NPV(C4, D3:H3)						
9			Inputs are rate and values						
10									

Discounted Cash Flow Valuation Example

Discounted Cash Flow Valuation Example					
	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
FCF	125,000	131,250	137,813	144,703	151,938
+ TV					531,784
= TCF	125,000	131,250	137,813	144,703	683,722
WACC =	25%				
NPV =	537,873				
WC =	35,000	*Working Capital injection required for business assuming average WC of \$35,000 and business will be sold "free and clear" with seller retaining Cash, AR and all liabilities.			
Business Value =	<u>572,873</u> (NPV + WC adjustment)				
Where					
FCF = Business free cash flow forecast					
TV = estimated terminal value of business (calculated by multiple or perpetuity model)					
TCF = total cash flows to discount					
WACC = weighted average cost of capital (typically 100% equity rate used)					
NPV = net present value of TCF discounted at WACC					
WC = working capital adjustment required based on deal structure; this could be zero					

*Remember, Excel assumes that all payments happen at the end of the period. Any "immediate" cash inflows/outflows need to be added to the NPV calculation; i.e. a \$10,000 working capital adjustment at closing has a \$10,000 NPV.

XII. Example Questions

Below are examples of the types of questions that can be expected on the CTA exam.

Multiple Choice

1. It is estimated that there are approximately _____ business brokers in the United States:
 - a. 1,000 – 2,000
 - b. 2,000 – 3,000
 - c. 3,000 – 5,000
 - d. More than 10,000

2. A transaction whereby the business assets are sold and transferred from the seller to the buyer and the seller retains the corporate stock is known as:
 - a. A stock sale
 - b. An asset sale
 - c. A basic sale
 - d. A transfer sale

3. An Information Memorandum on a business should only be released to prospective buyers:
 - a. After the buyer signs a confidentiality agreement
 - b. After the buyer has been screened by the broker and they have signed a confidentiality agreement
 - c. It should be shown to all prospective buyers to increase the chances of a sale
 - d. After the buyer has been interviewed by the business broker about their intent
 - e. Only after the prospective buyer signs a confidentiality agreement and the business broker receives a deposit so that the broker knows the buyer is serious

4. Standard adjustments to reported earnings in calculating Seller's Discretionary Cash Flow include all but the following:
 - a. Owner's wages
 - b. Car leased by the business but used for the owner personally
 - c. Reported depreciation expense
 - d. Rent
 - e. All are standard adjustments

5. How is the interest rate on a SBA backed loan determined?
 - a. It is negotiated by the lender and borrower
 - b. It is set by the bank making the loan
 - c. It is set by the SBA
 - d. It is based on the prime rate published in the Wall Street Journal

6. Business broker John is preparing to make cold calls to generate new clients. To help generate higher interest, his script includes telling prospective clients that he has a buyer interested in their business. This is an example of:
 - a. Violation of the commerce section of the do-not call law
 - b. Unethical behavior
 - c. An experienced broker with a good marketing strategy
 - d. A common “best practices” that works
 - e. None of the above

7. In an exclusive listing agreement, the business broker earns a fee _____
 - a. Regardless of who introduced the buyer to the seller
 - b. Only when the transaction closes
 - c. When the broker “procures a ready willing and able buyer”
 - d. When the seller decides to pay

8. All of the following are basic components of a Purchase & Sale Agreement except:
 - a. Representations & Warranties
 - b. Covenants
 - c. Demurrer clause
 - d. Conditions & Obligations
 - e. All are basic components

9. The most common representations and warranties in a Purchase Agreement that a buyer will require a seller to make typically involve all but:
 - a. Absence of undisclosed liabilities
 - b. Compliance with laws
 - c. Accuracy of financial statements
 - d. All will be required

10. All fifty states require a person to have a real estate license
 - a. To sell a business
 - b. To sell real estate
 - c. To sell a business and to sell real estate

11. John is a business consultant in a state that does not requires a real estate license to sell a business. John is approached by a client, Dave, who wants to employ John to sell his business. Dave owns a service business which is run out of a small professional office building that the business owns. The business has been valued at \$2,300,000 and the building valued at \$290,000. In this case, John can:
 - a. Represent Dave in the sale of the stock of the business, which includes the building; he does not need a real estate license
 - b. Represent Dave in neither sale of the business or the building since he does not have a real estate license
 - c. Represent Dave in the sale of the stock of the business but will need to exclude the building from the transaction since he does not have a real estate license

- d. Represent Dave in the sale of the business but not the building since he does not have a real estate license
12. A “Series 63” security license is issued by the:
- d. Securities and Exchange Commission
 - e. Financial Industry Regulatory Authority
 - f. National Association of Securities Dealers
 - g. State Securities Commission
13. John is a full time business broker who operates with a contract that clearly stipulates he receives a “Finder’s Fee” for introducing prospective buyers to sellers. He does not create any Information Memorandums for clients, provides no financial or valuation advice, and does not negotiate on his clients behalf. John recently listed for sale a company; the ad specifically said that prospective purchasers would be required to buy 100% of the stock of the company. A buyer responding to his ad purchased 100% of the stock of the company for \$500,000. Under these specific circumstances, John:
- a. Does not need to be a registered broker dealer as his activities fall under the Finder’s Fee exclusion to federal regulation
 - b. Does not need to be a registered broker dealer as his activities fall under the Small Business exclusion to federal regulation
 - c. Had a technical violation of the law but falls under the no-action guidelines of the SEC
 - d. Is in violation of federal securities laws and regulations.
14. Operating under the guidelines of an SEC no action letter means that:
- a. A person is protected from civil liability
 - b. A person is protected from criminal liability
 - c. It is a violation of a law but not a regulation
 - d. The SEC would probably not take any enforcement action
 - e. All of the above
15. What legal entity business structure offers limited liability to its owners?
- a. A sole proprietorship
 - b. A corporation
 - c. A general partnership
 - d. An ostensible partnership
16. Current Ratio is:
- a. Current Assets minus current liabilities
 - b. Current Assets divided by current liabilities
 - c. Current Assets, less inventory minus current liabilities
 - d. Current Assets, less inventory divided current liabilities
17. The purpose of recasting financial statements is to:
- a. Show a potential purchaser how much owner cash flow a business generates

- b. Get a higher sale price from a buyer
 - c. Fix any accounting errors that may be on internal financial statements
 - d. None of the above
18. The financial statement which shows the position of the business over a time period is the:
- a. Cash flow statement
 - b. Income statement
 - c. Balance sheet
 - d. Both A & B
19. Assume a business had \$550,000 in revenues, \$225,000 in cash operating expenses, \$50,000 in debt service of which \$10,000 was principal payments, and \$30,000 in depreciation. What is the before-tax cash flow from the business?
- a. \$275,000
 - b. \$305,000
 - c. \$325,000
 - d. \$365,000
20. A company has \$700,000 Owners' Equity and \$75,000 in liabilities. What are the assets for the company?
- a. \$625,000
 - b. \$700,000
 - c. \$775,000
 - d. None of the above
21. 3. A company has cash in the bank of \$450,000, inventory of \$150,000 and a building worth \$200,000. These are the only assets for the company. The company has liabilities that amount to \$500,000. How much is owners' equity in this company?
- a. \$200,000
 - b. \$100,000
 - c. \$300,000
 - d. None of the above
22. Most small businesses report their taxes on a:
- a. Cash basis
 - b. Accrual basis
 - c. IRS Accounting basis
 - d. According to GAAP standards
23. John sold the assets of his business for \$500,000. The purchase price was allocated as follows: \$100,000 furniture fixture, and equipment, \$290,000 goodwill, and \$60,000 for a 6 year non-compete agreement. The goodwill will be taxed:
- a. At the capital gains tax rate
 - b. As ordinary income in the year of the sale
 - c. As ordinary income each year a payment is received on it

- d. Goodwill is non-taxable
24. The basic accounting equation is:
- a. $\text{Assets} = \text{Liabilities} + \text{Equity}$
 - b. $\text{Assets} + \text{Liabilities} = \text{Equity}$
 - c. $\text{Assets} + \text{Equity} = \text{Liabilities}$
 - d. None of the above
25. Short-term liabilities are those that:
- a. Are due in 30 days or less
 - b. Are due in 180 days or less
 - c. Are due in 1 year or less
 - d. Are due in 5 years or less
26. Standard business valuation methods include all but:
- a. Income approach
 - b. Market approach
 - c. Asset approach
 - d. Accounting approach
27. The excess purchase price of a business over the book value of the business is known as:
- a. Profit
 - b. Common stock value
 - c. Goodwill
 - d. Equity value
28. A good benchmark for determining the risk free rate of an investment is:
- a. Current bank CD rates
 - b. Current bank standard savings account rates
 - c. Current U.S. Treasury Bond yields
 - d. Current Federal Funds Rate
29. If you deposited \$3,000 into a savings account paying 10% simple interest, how much money would you have in 3 years?
- a. \$3,300
 - b. \$3,900
 - c. \$3,975
 - d. \$4,045
30. A buyer offers to pay \$900,000 for a business by making 10 equal payments of \$90,000. He will pay \$90,000 at close and \$90,000 every twelve months until the balance is paid in full. Assuming money is worth 15% to the seller, what is the present cash value of the offer?
- a. \$451,689
 - b. \$519,443

- c. \$674,382
- d. \$810,000

True/False

- 31. A business broker who limits his activities to “finding” customers for, or making referrals to, registered broker-dealers does not need to register with the SEC.
- 32. The primary reason that businesses do not sell is over pricing.
- 33. To guarantee a loan to purchase a business, the Small Business Administration requires that the business can show it generates sufficient cash flow to pay back the loan and the buyer is qualified.
- 34. Even if a business broker has extensive experience reviewing Purchase Agreements, they should never draft a Purchase Agreement for their client in place of an attorney, thus saving their client money.
- 35. The Balance Sheet shows the financial position of a company, including assets, liabilities, and equity, at a specific period of time.

XIII. Answers to Example Questions

- 1) C
- 2) B
- 3) B
- 4) D
- 5) A
- 6) B
- 7) A
- 8) C
- 9) D
- 10) B
- 11) D
- 12) E
- 13) D
- 14) D
- 15) B
- 16) A
- 17) A
- 18) D
- 19) A
- 20) C
- 21) C
- 22) A
- 23) A
- 24) A
- 25) C
- 26) D
- 27) C
- 28) C
- 29) B
- 30) B
- 31) F
- 32) T
- 33) T
- 34) T
- 35) T