

Test Bank for Corporate Finance 12th Edition by Ross

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Test Bank

Corporate Finance, 12e (Ross)

Chapter 2 Financial Statements and Cash Flow

1) Which one of these accounts appears on the right-hand side of a balance sheet?

- A) Property, plant, and equipment
- B) Accumulated retained earnings
- C) Accumulated depreciation
- D) Cash and equivalents
- E) Intangible assets

Answer: B

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Understand

AACSB: Reflective Thinking

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2) The entire book value of the residual ownership of a corporation is known as the:

- A) total equity.
- B) intangible assets.
- C) retained earnings.
- D) capital surplus.
- E) total assets.

Answer: A

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Understand

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3) Which account represents the book value of all of a corporation's net profits less its dividend payments?

- A) Capital surplus
- B) Accumulated retained earnings
- C) Treasury stock
- D) Common stock
- E) Preferred stock

Answer: B

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Understand

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4) Which one of the following is a current liability?

- A) Amount due to a supplier in 18 months
- B) Note payable in nine months
- C) Estimated taxes just paid
- D) Loan payment due in 13 months
- E) Amount due from a customer in 30 days

Answer: B

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Understand

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5) An increase in total assets:

- A) means that net working capital is also increasing.
- B) requires an investment in fixed assets.
- C) means that stockholders' equity must also increase.
- D) must be offset by an equal increase in liabilities and stockholders' equity.
- E) can only occur when a firm has positive net income.

Answer: D

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Understand

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6) Which one of the following assets is generally the most liquid?

- A) Inventory
- B) Buildings
- C) Accounts receivable
- D) Equipment
- E) Patents

Answer: C

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Liquidity

Bloom's: Understand

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7) Which one of the following statements concerning liquidity is correct?

- A) Liquid assets generally earn higher rates of return than fixed assets.
- B) If you can sell an asset next year at a price equal to its actual value, the asset is highly liquid.
- C) Liquid assets are defined as those assets obtained within the past year.
- D) The less liquidity a firm has, the lower the probability the firm will encounter financial difficulties.
- E) Balance sheet accounts are listed in order of decreasing liquidity.

Answer: E

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Liquidity

Bloom's: Understand

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8) Liquidity is:

- A) a measure of the use of debt in a firm's capital structure.
- B) equal to current assets minus current liabilities.
- C) equal to the market value of a firm's total assets minus its total liabilities.
- D) valuable to a firm even though liquid assets tend to be less profitable to own.
- E) generally most associated with intangible assets.

Answer: D

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Liquidity

Bloom's: Understand

AACSB: Reflective Thinking

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9) Which one of the following accounts is included in stockholders' equity?

- A) Long-term debt
- B) Deferred taxes
- C) Plant and equipment
- D) Accumulated retained earnings
- E) Dividends paid

Answer: D

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Remember

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10) Book value:

- A) is equivalent to market value for firms with fixed assets.
- B) is based on historical cost.
- C) generally tends to exceed market value when fixed assets are included.
- D) is more of a financial than an accounting valuation.
- E) is adjusted whenever the market value of an asset changes.

Answer: B

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Understand

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11) If you sell an asset, you are most apt to receive which value for that asset?

- A) Market value
- B) Original cost minus accumulated depreciation
- C) Historical value
- D) Book value
- E) Carrying value

Answer: A

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Remember

AACSB: Reflective Thinking

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12) Which one of these equations is an accurate expression of the balance sheet?

- A) $\text{Assets} \equiv \text{Liabilities} - \text{Stockholders' equity}$
- B) $\text{Stockholders' equity} \equiv \text{Assets} + \text{Liabilities}$
- C) $\text{Liabilities} \equiv \text{Stockholders' equity} - \text{Assets}$
- D) $\text{Assets} \equiv \text{Stockholders' equity} - \text{Liabilities}$
- E) $\text{Stockholders' equity} \equiv \text{Assets} - \text{Liabilities}$

Answer: E

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Remember

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13) Which one of these accounts is classified as a fixed asset on the balance sheet?

- A) Intangible assets
- B) Accounts payable
- C) Preferred stock
- D) Inventory
- E) Accounts receivable

Answer: A

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Remember

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14) On a balance sheet, deferred taxes are classified as:

- A) stockholders' equity.
- B) a current asset.
- C) a long-term liability.
- D) a fixed asset.
- E) a current liability.

Answer: C

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Remember

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15) If a firm's financial managers successfully meet their primary goal, then the firm's:

- A) debts will exceed its equity.
- B) market value will exceed its book value.
- C) net working capital will exceed its long-term debt.
- D) carrying value will exceed its market value.
- E) equity will exceed its assets.

Answer: B

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Remember

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16) An asset that can be quickly converted into cash without significant loss in value is referred to as being:

- A) marketable.
- B) tangible.
- C) intangible.
- D) liquid.
- E) fixed.

Answer: D

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Liquidity

Bloom's: Remember

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17) Which one of these is related to an increase in the book value of the stockholders' equity in a profitable, non-dividend paying firm? Assume no shares of stock are repurchased or sold.

- A) A decrease in the book value of inventory
- B) An increase in earnings per share
- C) An increase in the market value of the firm's buildings
- D) An increase in the market value of the firm's long-term debt
- E) An increase in non-cash expenses

Answer: B

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Understand

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18) Assets are listed on the balance sheet in order of:

- A) decreasing liquidity.
- B) acquisition.
- C) increasing size.
- D) market value relative to book value.
- E) book value.

Answer: A

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Liquidity

Bloom's: Understand

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19) An increase in treasury stock:

- A) increases the total equity of the firm.
- B) is the result of a firm issuing new shares of stock to the federal government.
- C) increases the number of shares outstanding.
- D) results from a repurchase of outstanding shares of stock.
- E) requires repayment at some point in the future.

Answer: D

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Understand

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20) The book value of assets:

- A) is determined under Generally Accepted Accounting Principles (GAAP) and is based on the cost of those assets.
- B) represents the true market value of those assets according to GAAP.
- C) is always the best measure of the company's value to an investor.
- D) is always higher than the replacement cost of the assets.
- E) is shown on the firm's income statement.

Answer: A

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Generally Accepted Accounting Principles (GAAP)

Bloom's: Understand

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- 21) Under Generally Accepted Accounting Principles (GAAP), a firm's assets are reported at:
- A) market value.
 - B) liquidation value.
 - C) market value less accumulated depreciation.
 - D) historical cost less accumulated depreciation.
 - E) liquidation value less accumulated depreciation.

Answer: D

Difficulty: 1 Easy

Section: 2.1 The Balance Sheet

Topic: Generally Accepted Accounting Principles (GAAP)

Bloom's: Understand

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- 22) The income statement:
- A) measures performance for one specific day.
 - B) ignores any income other than operating revenues.
 - C) excludes deferred tax expense.
 - D) treats dividends paid as a cash expense.
 - E) includes noncash expenses.

Answer: E

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

- 23) According to Generally Accepted Accounting Principles (GAAP), revenue is recognized as income when:
- A) a contract is signed to perform a service or deliver a good.
 - B) the transaction is complete and the goods or services are delivered.
 - C) payment is requested.
 - D) income taxes are paid on the revenue earned.
 - E) managers decide to recognize it.

Answer: B

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Generally Accepted Accounting Principles (GAAP)

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

24) The financial statement summarizing a firm's accounting performance over a period of time is the:

- A) income statement.
- B) balance sheet.
- C) statement of cash flows.
- D) tax reconciliation statement.
- E) statement of equity.

Answer: A

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

25) Noncash items refer to:

- A) the credit sales of a firm.
- B) the accounts payable of a firm.
- C) the costs incurred for the purchase of intangible fixed assets.
- D) expenses charged against revenues that do not directly affect cash flow.
- E) all accounts on the balance sheet other than cash on hand.

Answer: D

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Noncash items

Bloom's: Remember

AACSB: Reflective Thinking

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26) For a firm with long-term debt, net income must be equal to:

- A) Pretax income – Interest expense – Taxes.
- B) EBIT – Taxes.
- C) Taxes + Addition to retained earnings.
- D) Operating income $\times$ (1 – Marginal tax rate).
- E) Dividends + Addition to retained earnings.

Answer: E

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Understand

AACSB: Reflective Thinking

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27) As seen on the income statement of a tax-paying firm:

- A) interest is deducted from income and increases the total taxes incurred.
- B) the tax rate is applied to the earnings before interest and taxes when the firm pays interest.
- C) depreciation is shown as an expense but does not affect the tax expense.
- D) depreciation reduces both the pretax income and the net income.
- E) interest expense is added to earnings before interest and taxes to compute pretax income.

Answer: D

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Understand

AACSB: Reflective Thinking

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28) All else held constant, the earnings per share will decrease as the:

- A) net income increases.
- B) number of shares outstanding increases.
- C) total revenue of the firm increases.
- D) tax rate decreases.
- E) costs decrease.

Answer: B

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Per-share valuations

Bloom's: Understand

AACSB: Reflective Thinking

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29) Which one of these statements is correct?

- A) Pretax income is equal to net income minus taxes.
- B) The addition to retained earnings is equal to net income plus dividends.
- C) Operating income is equal to operating revenue minus cost of goods sold.
- D) Only current taxes are included in the tax expense.
- E) Earnings per share can be negative but dividends per share cannot.

Answer: E

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Per-share valuations

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

30) Earnings per share:

- A) will increase if net income increases and the number of shares outstanding decreases.
- B) will increase if net income decreases and the number of shares outstanding increases.
- C) is defined as the addition to retained earnings divided by the number of shares outstanding.
- D) is the total amount of dividends paid per year on a per share basis.
- E) must increase at the same rate as the net income.

Answer: A

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Per-share valuations

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

31) Earnings per share will increase when:

- A) depreciation decreases.
- B) the number of shares outstanding increase.
- C) operating income decreases.
- D) dividends per share decrease.
- E) the average tax rate increases.

Answer: A

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Per-share valuations

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

32) Assuming the number of shares outstanding and total earnings remains constant, an increase in dividends per share will:

- A) reduce the earnings per share.
- B) reduce the addition to retained earnings.
- C) reduce net income.
- D) increase total equity.
- E) increase total assets.

Answer: B

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Per-share valuations

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

33) Which one of these is a non-cash item?

- A) Deferred taxes
- B) Interest expense
- C) Current taxes
- D) Dividends
- E) Selling expenses

Answer: A

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Noncash items

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

34) For a tax-paying firm, an increase in the depreciation expense of \$1 will:

- A) reduce net income by \$1.
- B) increase net income by \$1.
- C) reduce net income by more than \$1.
- D) reduce net income by less than \$1.
- E) increase net income by less than \$1.

Answer: D

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Noncash items

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

35) According to Generally Accepted Accounting Principles (GAAP), the cost of goods sold expenses are:

- A) recorded as incurred.
- B) recorded when paid.
- C) matched with revenues.
- D) matched with production levels.
- E) expensed as management desires.

Answer: C

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Generally Accepted Accounting Principles (GAAP)

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

36) Depreciation for a profitable firm:

- A) decreases both operating and net income.
- B) increases the net fixed assets as shown on the balance sheet.
- C) reduces both the net fixed assets and the costs of a firm.
- D) is a non-cash expense which increases the net operating income.
- E) decreases net fixed assets, net income, and operating cash flows.

Answer: A

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Noncash items

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

37) Which one of these is most apt to be a fixed, cash expense in the short run?

- A) Raw materials cost
- B) Bond interest
- C) Commissions paid to sales representatives
- D) Depreciation
- E) Manufacturing labor costs

Answer: B

Difficulty: 1 Easy

Section: 2.2 The Income Statement

Topic: Fixed and variable costs

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

38) When you are making a financial decision, the most relevant tax rate is the _____ rate when the tax rate schedule is progressive.

- A) average
- B) fixed
- C) marginal
- D) total
- E) variable

Answer: C

Difficulty: 1 Easy

Section: 2.3 Taxes

Topic: Taxes

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

39) Which term defines the tax rate that applies to the next dollar of taxable income earned?

- A) Deductible
- B) Residual
- C) Total
- D) Average
- E) Marginal

Answer: E

Difficulty: 1 Easy

Section: 2.3 Taxes

Topic: Taxes

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

40) As of 2018, the U.S. corporate tax rate is:

- A) based on a progressive tax rate schedule.
- B) based on a tiered, multi-rate flat tax.
- C) a flat tax of 34 percent.
- D) zero with all corporate taxable income passed to shareholders.
- E) a flat rate of 21 percent.

Answer: E

Difficulty: 1 Easy

Section: 2.3 Taxes

Topic: Taxes

Bloom's: Remember

AACSB: Reflective Thinking

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41) A firm starts its year with positive net working capital. During the year, the firm acquires more short-term debt than it does short-term assets. This means that:

- A) the ending net working capital must be negative.
- B) both accounts receivable and inventory decreased during the year.
- C) the beginning current assets were less than the beginning current liabilities.
- D) accounts payable increased and inventory decreased during the year.
- E) the ending net working capital can be positive, negative, or equal to zero.

Answer: E

Difficulty: 1 Easy

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Understand

AACSB: Reflective Thinking

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42) For a growing firm, the change in net working capital is generally:

- A) positive.
- B) negative.
- C) highly erratic.
- D) highly negative.
- E) equal to zero.

Answer: A

Difficulty: 1 Easy

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

43) An increase in which one of the following will cause the operating cash flow to increase for a profitable firm?

- A) Depreciation
- B) Cash
- C) Net working capital
- D) Taxes
- E) Administrative expenses

Answer: A

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

44) Which one of these does *not* affect the cash flow to creditors?

- A) Interest paid on long-term debt
- B) New mortgage on a building
- C) Increase in accounts payable
- D) Mortgage interest payment
- E) Reduction in long-term debt

Answer: C

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to creditors

Bloom's: Understand

AACSB: Reflective Thinking

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- 45) A firm's dividend payments less any net new equity raised is referred to as the firm's:
- A) operating cash flow.
 - B) capital spending.
 - C) net working capital.
 - D) cash flow from creditors.
 - E) cash flow to stockholders.

Answer: E

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to stockholders

Bloom's: Remember

AACSB: Reflective Thinking

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- 46) Which one of these will cause an increase in the cash flow to creditors for the current year?
- A) Collection of a refund for the overpayment of a loan
 - B) Payoff of a 36-month loan after the first 15 months
 - C) Payment of a late charge on an account payable to a supplier
 - D) Acquiring a new loan that will be repaid in one lump sum 24 months from now
 - E) Purchasing inventory using credit offered by a supplier

Answer: B

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to creditors

Bloom's: Understand

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- 47) The cash flow to stockholders must be positive when:
- A) the dividends paid are less than the amount of net new equity raised.
 - B) the net sale of common stock exceeds the amount of dividends paid.
 - C) no income is distributed but new shares of stock are sold.
 - D) the cash flow from assets is positive and exceeds the cash flow to creditors.
 - E) both the cash flow to assets and the cash flow to creditors are positive.

Answer: D

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to stockholders

Bloom's: Understand

AACSB: Reflective Thinking

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48) Cash flow from assets:

- A) equals net income plus non-cash items.
- B) can be positive, negative, or equal to zero.
- C) equals operating cash flow minus net capital spending.
- D) equals the addition to retained earnings.
- E) equals operating cash flow minus the cash flow to creditors.

Answer: B

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Understand

AACSB: Reflective Thinking

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49) Net capital spending is equal to the:

- A) net change in total assets plus depreciation.
- B) net change in fixed assets plus depreciation.
- C) net income plus depreciation.
- D) difference between the market and book values of the total assets.
- E) change in total assets.

Answer: B

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

50) Cash flow to stockholders is defined as:

- A) cash dividends paid.
- B) repurchases of equity less new equity sold minus cash dividends paid.
- C) cash flow from financing less cash flow to creditors.
- D) cash dividends paid plus repurchases of equity minus new equity financing.
- E) cash flow from assets plus cash flow to creditors.

Answer: D

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to stockholders

Bloom's: Understand

AACSB: Reflective Thinking

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51) Free cash flow is:

- A) the money generated from the sale of new shares of stock.
- B) another term for operating cash flow.
- C) the cash generated by decreasing net working capital.
- D) cash that the firm can distribute to creditors and stockholders.
- E) the net income of a firm after taxes have been paid.

Answer: D

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Free cash flow

Bloom's: Remember

AACSB: Reflective Thinking

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52) The cash flow of the firm must be equal to the:

- A) cash flow to stockholders minus the cash flow to creditors.
- B) cash flow to creditors minus the cash flow to stockholders.
- C) cash flow to governments plus the cash flow to stockholders.
- D) cash flow to stockholders plus the cash flow to creditors.
- E) aftertax operating cash flow.

Answer: D

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

53) The cash flow resulting from a firm's ongoing, normal business activities is referred to as the:

- A) operating cash flow.
- B) net capital spending.
- C) additions to net working capital.
- D) free cash flow.
- E) cash flow to investors.

Answer: A

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

54) Capital spending is equal to:

- A) ending net fixed assets minus beginning net fixed assets.
- B) ending net fixed assets minus beginning net fixed assets plus depreciation.
- C) ending total assets minus beginning total assets.
- D) ending total assets minus beginning total assets plus depreciation.
- E) beginning total assets plus asset purchases minus asset sales.

Answer: B

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Capital spending

Bloom's: Remember

AACSB: Reflective Thinking

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55) Operating cash flow is defined as:

- A) Pretax income – Taxes.
- B) Net income – Dividends.
- C) EBIT + Depreciation – Taxes.
- D) Pretax income + Depreciation.
- E) Cash flow to investors + Taxes.

Answer: C

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Remember

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56) Payments to creditors that include interest and the repayment of principal are referred to as:

- A) the cash flow to stockholders.
- B) the reduction in net working capital.
- C) debt service.
- D) operating cash flow.
- E) the change in net working capital.

Answer: C

Difficulty: 1 Easy

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Remember

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

57) In the accounting statement of cash flows, which one of these is calculated by adding back noncash expenses to net income and adjusting for changes in current assets and liabilities?

- A) Cash flow from investing activities
- B) Cash flow from financing activities
- C) Net working capital
- D) Cash flow from operations
- E) Cash flow to investors

Answer: D

Difficulty: 1 Easy

Section: 2.6 The Accounting Statement of Cash Flows

Topic: Statement of cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

58) The accounting statement of cash flows consists of the cash flows from:

- A) operations, investing activities, and financing activities.
- B) operations, investing activities, and divesting activities.
- C) internal activities, external activities, and financing activities.
- D) balance sheet accounts only.
- E) income statement accounts only.

Answer: A

Difficulty: 1 Easy

Section: 2.6 The Accounting Statement of Cash Flows

Topic: Statement of cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

59) In the accounting statement of cash flows, interest expense is:

- A) ignored completely.
- B) included as a financing activity.
- C) included both as an operating and as a financing activity.
- D) included as an investing activity.
- E) included in operations.

Answer: E

Difficulty: 1 Easy

Section: 2.6 The Accounting Statement of Cash Flows

Topic: Statement of cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

60) One of the reasons why cash flow analysis is popular is because:

- A) cash flows are more subjective than net income.
- B) deferred taxes require future cash payment.
- C) cash flows are strictly defined by Generally Accepted Accounting Principles (GAAP).
- D) it is difficult to manipulate, or spin the cash flows.
- E) operating cash flows are found on the income statement.

Answer: D

Difficulty: 1 Easy

Section: 2.7 Cash Flow Management

Topic: Cash flows

Bloom's: Understand

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

61) Total equity is \$1,620, fixed assets are \$1,810, long-term debt is \$650, and short-term debt is \$300. What is the amount of current assets?

- A) \$760
- B) \$360
- C) \$1,140
- D) \$480
- E) \$790

Answer: A

Explanation: $\text{Current assets} = \$1,620 + 650 + 300 - 1,810$

Current assets = \$760

Difficulty: 2 Medium

Section: 2.1 The Balance Sheet

Topic: Balance sheet

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

62) Southwest Co. has equipment with a book value of \$3,560 that could be sold today for \$3,900. Its inventory is valued at \$1,780 and could be sold immediately to a competitor at a discount of 25 percent. The firm has \$260 in cash and customers owe the firm \$950, of which 98 percent is collectible. What is the current market value of the firm's assets?

- A) \$6,086
- B) \$5,536
- C) \$6,426
- D) \$6,316
- E) \$5,946

Answer: C

Explanation: $\text{Market value of assets} = \$260 + .98(\$950) + (1 - .25)(\$1,780) + \$3,900$

Market value of assets = \$6,426

Difficulty: 2 Medium

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

63) Martha's Enterprises spent \$4,100 to purchase equipment three years ago. This equipment is currently valued at \$2,700 on today's balance sheet but could actually be sold for \$3,200. Net working capital is \$400 and long-term debt is \$2,300. Assuming the equipment is the firm's only fixed asset, what is the book value of shareholders' equity?

- A) \$1,300
- B) \$800
- C) \$1,600
- D) \$1,900
- E) \$2,200

Answer: B

Explanation: $\text{Book value of equity} = \$400 + 2,700 - 2,300$

Book value of equity = \$800

Difficulty: 2 Medium

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

64) Mart's Boutique has sales of \$820,000 and costs of \$540,000. Interest expense is \$36,000 and depreciation is \$59,000. The tax rate is 21 percent. What is the net income?

- A) \$221,200
- B) \$146,150
- C) \$105,000
- D) \$179,250
- E) \$139,050

Answer: B

Explanation: $\text{Net income} = (\$820,000 - \$540,000 - \$59,000 - \$36,000)(1 - .21)$

Net income = \$146,150

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

65) Upton Industries has revenues of \$42,629, interest expense of \$1,230, depreciation of \$2,609, cost of goods sold of \$23,704, dividends paid of \$1,200, and administrative expenses of \$7,040. Assume the tax rate is 22 percent. What is the addition to retained earnings?

- A) \$5,075.88
- B) \$4,630.19
- C) \$3,766.67
- D) \$4,903.18
- E) \$5,230.04

Answer: A

Explanation: $\text{Net income} = (\$42,629 - \$23,704 - \$7,040 - \$2,609 - \$1,230)(1 - .22)$

Net income = \$6,275.88

Addition to retained earnings = $\$6,275.88 - \$1,200$

Addition to retained earnings = \$5,075.88

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

66) This year, Johnson Mills has annual revenue of \$37,800, cost of goods sold of \$23,200, and administrative expenses of \$6,300. The firm paid \$700 in dividends, \$280 in interest, and has a total tax rate of 21 percent. The firm will add \$2,810 to retained earnings. What is the depreciation expense?

- A) \$2,300
- B) \$3,709
- C) \$2,640
- D) \$780
- E) \$3,577

Answer: E

Explanation: Net income = \$700 + 2,810

Net income = \$3,510

Pretax income = $\$3,510 / (1 - .21)$

Pretax income = \$4,443

Depreciation expense = $\$37,800 - 23,200 - 6,300 - 280 - 4,443$

Depreciation expense = \$3,577

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

67) Delfinio's has total revenues of \$4,315, selling and administrative expenses of \$611, depreciation of \$309, cost of goods sold of \$2,403, taxes of \$178, dividends of \$80, and interest expense of \$168. What is the amount of the non-cash items?

- A) \$481
- B) \$477
- C) \$248
- D) \$309
- E) \$567

Answer: D

Explanation: Non-cash items = Depreciation = \$309

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Noncash items

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

68) Deep Water Mining added \$411 to retained earnings last year on sales of \$24,646. The administrative expenses were \$4,370, depreciation was \$812, dividends paid were \$285, and the interest expense was \$103. What was the cost of goods sold if the total tax rate was 23 percent?

- A) \$20,225
- B) \$24,385
- C) \$18,457
- D) \$14,815
- E) \$21,393

Answer: C

Explanation: Net income = \$285 + 411

Net income = \$696

Pretax income = $\$696 / (1 - .23)$

Pretax income = \$904

COGS = $\$24,646 - 4,370 - 812 - 103 - 904$

COGS = \$18,457

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

69) Daniels Transport has operating income of \$68,200, interest expense of \$210, dividends paid of \$320, depreciation of \$12,400, other income of \$2,100, common stock of \$48,500 with a par value of \$1 per share, and retained earnings of \$29,700. What is the earnings per share if the tax rate is 21 percent?

- A) \$1.14
- B) \$1.21
- C) \$.82
- D) \$.96
- E) \$1.33

Answer: A

Explanation: Net income = $(\$68,200 + 2,100 - 210)(1 - .21)$

Net income = \$55,371.10

EPS = $\$55,371.10 / (\$48,500 / \$1)$

EPS = \$1.14

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Per-share valuations

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

70) Given the personal income tax rates as shown, what is the average tax rate for an individual with taxable income of \$118,700?

Taxable Income	Tax Rate
\$ 0 – 9,525	10%
9,526 – 38,700	12
38,701 – 82,500	22
82,501 – 157,500	24

- A) 24.00 percent
- B) 22.36 percent
- C) 19.00 percent
- D) 21.94 percent
- E) 21.00 percent

Answer: C

Explanation: Tax = $.10(\$9,525) + .12(\$38,700 - 9,525) + .22(\$82,500 - 38,700) + .24(\$118,700 - 82,500)$

Tax = \$22,777.50

Average tax rate = $\$22,777.50 / \$118,700$

Average tax rate = .19, or 19%

Difficulty: 2 Medium

Section: 2.3 Taxes

Topic: Taxes

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

71) AC Motors is a sole proprietorship that has taxable income of \$94,200. How much additional tax will be owed if the taxable income increases by \$14,300 based on the following tax rates? Assume this is the sole source of income for the owner.

Taxable Income	Tax Rate
\$ 0 – 9,525	10%
9,526 – 38,700	12
38,701 – 82,500	22
82,501 – 157,500	24

- A) \$3,862
- B) \$3,039
- C) \$3,406
- D) \$3,432
- E) \$3,678

Answer: D

Explanation: Additional tax = $.24(\$14,300)$

Additional tax = \$3,432

Difficulty: 2 Medium

Section: 2.3 Taxes

Topic: Taxes

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

72) Assume Juno's paid \$368,060 in taxes on taxable income of \$1,673,000 last year. This year, the firm paid \$401,545 in taxes on taxable income of \$1,818,586. Assume the tax rates were the same for both years. What are the marginal and average tax rates for this year?

- A) 21 percent; 21 percent
- B) 22 percent; 21 percent
- C) 23 percent; 22 percent
- D) 22 percent; 22 percent
- E) 23 percent; 21 percent

Answer: C

Explanation: Marginal tax rate = $(\$401,545 - 368,060)/(\$1,818,586 - 1,673,000)$

Marginal tax rate = .23, or 23%

Average tax rate = $\$401,545/\$1,818,586$

Average tax rate = .22, or 22%

Difficulty: 2 Medium

Section: 2.3 Taxes

Topic: Taxes

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

73) A firm has \$820 in inventory, \$3,200 in fixed assets, \$1,210 in accounts receivable, \$890 in accounts payable, and \$360 in cash. What is the amount of the net working capital?

- A) \$4,700
- B) \$5,590
- C) \$3,600
- D) \$2,390
- E) \$1,500

Answer: E

Explanation: $NWC = \$360 + 1,210 + 820 - 890$

$NWC = \$1,500$

Difficulty: 2 Medium

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

74) A firm has \$820 in inventory, \$3,200 in fixed assets, \$670 in accounts receivable, \$390 in accounts payable, \$500 in long-term debt, and \$360 in cash. What is the amount of the net working capital?

- A) \$890
- B) \$960
- C) \$3,600
- D) \$3,340
- E) \$1,460

Answer: E

Explanation: $NWC = \$360 + 670 + 820 - 390$

$NWC = \$1,460$

Difficulty: 2 Medium

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

75) At the beginning of the year, a firm had total assets of \$51,400, fixed assets of \$32,800, and current liabilities of \$13,280. At the end of the year, the current assets are \$14,800, the fixed assets are \$34,100, and the current liabilities are \$14,210. What is the change in net working capital for the year?

- A) -\$18,930
- B) -\$6,950
- C) \$11,470
- D) -\$4,730
- E) \$9,110

Answer: D

Explanation: $\Delta NWC = (\$14,800 - 14,210) - (\$51,400 - 32,800 - 13,280)$

$\Delta NWC = -\$4,730$

Difficulty: 2 Medium

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

76) Blauser's started the year with \$280 in cash, \$924 in inventory, \$361 in accounts payable, \$1,687 in equipment, and \$414 in accounts receivable. At year's end, the firm had \$311 in cash, \$1,594 in equipment, \$1,003 in inventory, \$426 in accounts receivable, and \$398 in accounts payable. What was the change in net working capital during the year?

- A) -\$860
- B) \$191
- C) \$85
- D) -\$94
- E) -\$206

Answer: C

Explanation: $\Delta NWC = (\$311 + 426 + 1,003 - 398) - (\$280 + 414 + 924 - 361)$

$\Delta NWC = \$85$

Difficulty: 2 Medium

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

77) Foxglove Interiors has net fixed assets of \$38,215, long-term debt of \$22,400, cash of \$560, accounts payable \$4,611, inventory of \$11,408, and accounts receivable of \$3,462. How much net working capital does the firm have?

- A) \$11,634
- B) \$26,634
- C) \$13,117
- D) \$10,819
- E) \$14,736

Answer: D

Explanation: $NWC = \$560 + 3,462 + 11,408 - 4,611$

$NWC = \$10,819$

Difficulty: 2 Medium

Section: 2.4 Net Working Capital

Topic: Net working capital

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

78) A debt-free firm has total sales of \$22,980, costs of \$14,715, and depreciation of \$6,045. What is the operating cash flow at a tax rate of 23 percent?

- A) \$1,465.20
- B) \$2,410.80
- C) \$8,340.00
- D) \$7,754.40
- E) \$9,019.80

Answer: D

Explanation: $EBIT = \$22,980 - 14,715 - 6,045$

$EBIT = \$2,220$

$Tax = \$2,220(.23)$

$Tax = \$510.60$

$OCF = \$2,220 + 6,045 - 510.60$

$OCF = \$7,754.40$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

79) Awnings Inc. has beginning net fixed assets of \$234,100 and ending net fixed assets of \$243,600. Assets valued at \$42,500 were sold during the year. Depreciation was \$62,500. What is the amount of net capital spending?

- A) -\$42,500
- B) \$9,500
- C) \$72,000
- D) \$53,000
- E) \$29,500

Answer: C

Explanation: $\text{Net capital spending} = \$243,600 - 234,100 + 62,500$

$\text{Net capital spending} = \$72,000$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Capital spending

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

80) At the beginning of the year, long-term debt of a firm is \$2,400 and total debt is \$3,150. At the end of the year, long-term debt is \$2,800 and total debt is \$4,370. The interest paid is \$40. What is the amount of the cash flow to creditors?

- A) \$440
- B) -\$40
- C) \$1,260
- D) \$1,180
- E) -\$360

Answer: E

Explanation: $\text{CF}(B) = \$40 - (\$2,800 - 2,400)$

$\text{CF}(B) = -\$360$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to creditors

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

81) Pete's Boats has beginning long-term debt of \$840 and ending long-term debt of \$790. The beginning and ending total debt balances are \$1,220 and \$1,360, respectively. The interest paid is \$30. What is the amount of the cash flow to creditors?

- A) \$80
- B) -\$110
- C) \$110
- D) \$20
- E) -\$80

Answer: A

Explanation: $CF(B) = \$30 - (\$790 - 840)$

$CF(B) = \$80$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to creditors

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

82) For the year, Peggy Grey's Cookies had net income of \$8,110. The firm paid out 30 percent of the net income to its shareholders as dividends and also paid \$210 in interest. During the year, the company repurchased \$500 worth of common stock and borrowed \$250. What is the cash flow to stockholders?

- A) \$2,933
- B) \$1,893
- C) \$1,933
- D) \$2,433
- E) \$2,893

Answer: A

Explanation: $CF(S) = .30(\$8,110) - (-\$500)$

$CF(S) = \$2,933$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to stockholders

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

83) Thompson's Jet Skis has operating cash flow of \$11,618. Depreciation is \$2,345 and interest paid is \$395. A net total of \$485 was paid on long-term debt. The firm spent \$6,180 on fixed assets and decreased net working capital by \$420. What is the cash flow of the firm?

- A) \$5,858
- B) \$8,203
- C) \$9,228
- D) \$5,018
- E) \$7,363

Answer: A

Explanation: $CF(A) = \$11,618 - 6,180 - (-\$420)$

$CF(A) = \$5,858$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

84) Lester's Markets has total revenues of \$3,811, costs of \$2,902, depreciation of \$315, interest expense of \$168, and taxes of \$89. At the beginning of the year, the firm had current assets of \$2,150, total assets of \$4,908, and total liabilities of \$1,964. At the end of the year, the current assets are \$2,202, total assets are \$5,103, and total liabilities are \$1,952. What is the amount of net capital spending for the year?

- A) -\$182
- B) \$133
- C) \$458
- D) \$510
- E) \$285

Answer: C

Explanation: $\text{Net capital spending} = (\$5,103 - 2,202) - (\$4,908 - 2,150) + \315

$\text{Net capital spending} = \458

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Capital spending

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

85) The General Store has total revenue of \$4,116, depreciation of \$319, selling and administrative expenses of \$554, interest expense of \$162, dividends of \$75, cost of goods sold of \$2,354, and taxes of \$186. What is the operating cash flow?

- A) \$1,118
- B) \$795
- C) \$1,147
- D) \$1,022
- E) \$720

Answer: D

Explanation: $OCF = \$4,116 - 2,354 - 554 - 186$

$OCF = \$1,022$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

86) Right Way Movers has interest expense of \$168, total revenues of \$38,411, costs of \$28,515, depreciation of \$306, and taxes of \$1,979. The beginning balance sheet has total assets of \$48,354, net fixed assets of \$31,202, current liabilities of \$14,207, and total liabilities of \$29,407. The ending balance sheet shows total assets of \$49,305, net fixed assets of \$33,406, current liabilities of \$17,318, and total liabilities of \$30,404. What is the annual cash flow of the firm?

- A) \$9,771
- B) -\$2,160
- C) \$15,168
- D) \$8,474
- E) \$2,857

Answer: A

Explanation: $OCF = \$38,411 - 28,515 - 1,979$

$OCF = \$7,917$

$\text{Net capital spending} = \$33,406 - 31,202 + 306$

$\text{Net capital spending} = \$2,510$

$\Delta NWC = (\$49,305 - 33,406 - 17,318) - (\$48,354 - 31,202 - 14,207)$

$\Delta NWC = -\$4,364$

$CF(A) = \$7,917 - 2,510 - (-\$4,364)$

$CF(A) = \$9,771$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

87) For a given year, Mfg. Corp. had taxable income of \$1,630 and a tax rate of 23 percent. The firm neither issued nor repurchased shares of stock but did decrease its retained earnings by \$310. What is the cash flow to stockholders?

- A) \$1,749.50
- B) \$535.50
- C) \$959.50
- D) \$1,242.50
- E) \$1,565.10

Answer: E

Explanation: Net income = $\$1,630(1 - .23)$

Net income = \$1,255.10

$CF(S) = \$1,255.10 - (-\$310)$

$CF(S) = \$1,565.10$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to stockholders

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

88) Northern Express paid \$85 in dividends and \$110 in interest expense during a given year. During that same year, the firm issued \$40 in new equity shares, issued new debt of \$65, and repaid \$23 of old debt. What is the cash flow to creditors for that year?

- A) \$152
- B) \$146
- C) \$237
- D) \$68
- E) \$46

Answer: D

Explanation: $CF(B) = \$110 - (\$65 - 23)$

$CF(B) = \$68$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to creditors

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

89) At the beginning of this year, Blauser Industries had net fixed assets of \$21,506 and total assets of \$32,687. At year's end, net fixed assets are \$20,492 and total assets are \$32,915. The annual depreciation expense is \$1,520. What is net capital spending for this year?

- A) -\$850
- B) \$506
- C) -\$1,292
- D) -\$2,534
- E) \$1,748

Answer: B

Explanation: Net capital spending = $\$20,492 - 21,506 + 1,520$

Net capital spending = \$506

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Capital spending

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

90) For the year, Jensen's has depreciation of \$2,058, dividends paid of \$125, interest expense of \$382, an addition to retained earnings of \$3,408, and an increase in common stock of \$2,500. The total tax rate is 21 percent. What is the operating cash flow?

- A) \$6,460
- B) \$5,973
- C) \$5,325
- D) \$5,735
- E) \$6,408

Answer: B

Explanation: Net income = $\$125 + 3,408$

Net income = \$3,533

Pre-tax income = $\$3,533 / (1 - .21)$

Pre-tax income = \$4,472.15

EBIT = $\$4,472.15 + 382$

EBIT = \$4,854.15

OCF = $\$4,854.15 + 2,058 - (\$4,472.15 - 3,533)$

OCF = \$5,973

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

91) Ledger Properties has the following financial information:

	Current Year	Prior Year
Revenues	\$ 48,915	\$ 43,610
Administrative expenses	12,106	11,602
Interest expense	816	468
Cost of goods sold	29,715	26,309
Depreciation	1,408	1,387
Net fixed assets	32,711	31,984
Current liabilities	14,652	14,625
Common stock	15,000	14,000
Current assets	16,506	14,687
Long-term debt	12,200	?
Retained earnings	7,365	4,246
Dividends paid	290	275

What is the cash flow of the firm for the current year if the tax rate is 22 percent?

- A) \$1,885
- B) \$1,042
- C) \$2,297
- D) \$2,096
- E) \$2,517

Answer: D

Explanation: Pretax income = $\$48,915 - 29,715 - 12,106 - 1,408 - 816$

Pretax income = $\$4,870$

Tax = $.22(\$4,870)$

Tax = $\$1,071$

OCF = $\$48,915 - 29,715 - 12,106 - 1,071$

OCF = $\$6,023$

Net capital spending = $\$32,711 - 31,984 + 1,408$

Net capital spending = $\$2,135$

Change in NWC = $(\$16,506 - 14,652) - (\$14,687 - 14,625)$

Change in NWC = $\$1,792$

Cash flow of the firm = $\$6,023 - 2,135 - 1,792$

Cash flow of the firm = $\$2,096$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

92) For a given year, Rogers Express paid \$318 in interest, \$460 in dividends, and \$368 in taxes. The firm had a net income of \$1,220, depreciation of \$1,560, an increase in net working capital of \$220, an increase in net fixed assets of \$950, and a decrease in long-term debt of \$260. There were no changes in the equity accounts other than the change in retained earnings. What is the annual cash flow of the firm?

- A) \$3,148
- B) \$1,610
- C) \$2,780
- D) \$1,038
- E) \$50

Answer: D

Explanation: $CF(B) = \$318 + 260$

$CF(B) = \$578$

$CF(S) = \$460$

$CF(A) = \$578 + 460$

$CF(A) = \$1,038$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

93) JK Meadows has beginning current liabilities of \$14,602 and total liabilities of \$35,418. At the end of the year, the current liabilities are \$15,311 and the total liabilities are \$37,604. During the year, the firm paid \$680 in dividends and \$1,320 in interest. What is the cash flow to creditors?

- A) \$3,230
- B) \$2,797
- C) \$3,135
- D) -\$157
- E) -\$267

Answer: D

Explanation: $CFC = \$1,320 - [(\$37,604 - 15,311) - (\$35,418 - 14,602)]$

$CFC = -\$157$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to creditors

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

94) During the year, Lasko's repaid \$12,500 in long-term debt, borrowed \$8,400, paid \$611 in interest and \$740 in dividends, and had an operating cash flow of \$16,207. The firm acquired \$33,500 in new fixed assets and sold \$8,400 of old assets. Net working capital declined by \$1,592 during the year. What is the annual cash flow to stockholders?

- A) \$1,200
- B) -\$2,590
- C) -\$8,828
- D) -\$12,012
- E) \$2,800

Answer: D

Explanation: Cash flow of the firm = $\$16,207 - 33,500 + 8,400 - (-\$1,592)$

Cash flow of the firm = $-\$7,301$

CFC = $\$611 + 12,500 - 8,400$

CFC = $\$4,711$

CFS = $-\$7,301 - 4,711$

CFS = $-\$12,012$

Difficulty: 3 Hard

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow to stockholders

Bloom's: Evaluate

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

95) Last year, Webster Farms had annual revenue of \$87,200, depreciation of \$11,600, cost of goods sold of \$54,700, and administrative expenses of \$8,300. The firm paid \$3,200 in dividends and paid taxes of \$2,646. What was the operating cash flow?

- A) \$21,500
- B) \$18,300
- C) \$23,100
- D) \$21,554
- E) \$23,700

Answer: D

Explanation: OCF = $\$87,200 - 54,700 - 8,300 - 2,646$

OCF = $\$21,554$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

96) Last year, Oscar's Dog Treats had a cash flow to creditors of \$2,840 and a cash flow to stockholders of \$1,630. The firm spent a net of \$1,420 on fixed assets and reduced net working capital by \$330. What was the operating cash flow?

- A) \$6,190
- B) \$5,560
- C) \$3,500
- D) \$1,320
- E) \$4,901

Answer: B

Explanation: $CF(A) = \$2,840 + 1,630$

$CF(A) = \$4,470$

$\$4,470 = OCF - \$1,420 - (-\$330)$

$OCF = \$5,560$

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Analyze

AACSB: Analytical Thinking

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97) Quick Marts increased its cash by \$418 this year. The firm's statement of cash flows shows total cash flow from financing activities of \$246 and total cash flow from investing activities of -\$184. What is the total cash flow from operations on this accounting statement?

- A) \$480
- B) \$356
- C) \$427
- D) \$367
- E) \$391

Answer: B

Explanation: $\$418 = \text{Total cash flow from operations} - 184 + 246$

Total cash flow from operations = \$356

Difficulty: 2 Medium

Section: 2.6 The Accounting Statement of Cash Flows

Topic: Statement of cash flows

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

98) JJ's has net sales of \$48,920, depreciation of \$711, cost of goods sold of \$31,890, administrative costs of \$11,210, interest expense of \$680, dividends paid of \$450, and taxes of \$974. What is the cash flow from operations as it will appear on the accounting statement of cash flows if the firm spent \$274 on net working capital?

- A) \$3,892
- B) \$3,056
- C) \$4,066
- D) \$3,667
- E) \$3,391

Answer: A

Explanation: $\text{Cash flow from operations} = \$48,920 - 31,890 - 11,210 - 680 - 974 - 274$
 $\text{Cash flow from operations} = \$3,892$

Note that the accounting statement of cash flows includes the interest expense as an operating activity.

Difficulty: 2 Medium

Section: 2.6 The Accounting Statement of Cash Flows

Topic: Statement of cash flows

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

99) Define liquidity and explain what a firm would need to do to ensure all of the current assets displayed on its balance sheet are liquid.

Answer: Liquid assets are those that can be sold quickly with little or no loss in value. To ensure the current assets are liquid, the firm needs to review its accounts receivable to ensure the accounts are collectible and also review its inventory to ensure it can be sold for at least its recorded book value.

Difficulty: 2 Medium

Section: 2.1 The Balance Sheet

Topic: Liquidity

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

100) Discuss the difference between book values and market values on the balance sheet and explain the best method for determining the value of a firm to its stockholders.

Answer: The accounts on the balance sheet are generally carried at historical cost, not market values. Although the book value of current assets and current liabilities may closely approximate market values, the same cannot be said for the rest of the balance sheet accounts. Ultimately, stockholders should focus on the firm's stock price, which is a market value measure, for the value of their investment in the firm.

Difficulty: 2 Medium

Section: 2.1 The Balance Sheet

Topic: Market and book values

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

101) Note that in all of our computations to determine the cash flows of a firm, we never include the addition to retained earnings. Why not? Is this an oversight?

Answer: The addition to retained earnings is not a cash flow; it is simply an accounting entry that links the income statement to the balance sheet and shows that the earnings of the firm accrue to stockholders.

Difficulty: 2 Medium

Section: 2.2 The Income Statement

Topic: Income statement

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

102) From a financial perspective, why is interest expense excluded from the operating cash flow?

Answer: Operating cash flow is designed to represent the cash flow a firm generates from its day-to-day operations. Interest expense arises from a financing decision and thus is considered in finance as a cash flow to creditors.

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Apply

AACSB: Knowledge Application

Accessibility: Keyboard Navigation

103) Explain why the income statement is not a good representation of cash flow.

Answer: Most income statements contain some noncash items, such as depreciation, which reduce net income but do not affect the cash flows. More importantly, however, income statements are prepared using GAAP guidelines which record revenues and expenses as sales are completed, not when their corresponding cash flows occur.

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flows

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

104) Depreciation is classified as a noncash item because no cash is spent when depreciation is recorded. Why are expenses that have been accrued, but not yet paid, not also considered to be noncash items and therefore excluded from operating cash flow just as depreciation is excluded?

Answer: Accrued expenses will appear in accounts payable and affect the change in net working capital. Via the change in net working capital, these unpaid expenses are subtracted from the operating cash flow to determine the cash flow of the firm. This method allows for the computation of the cash flows based solely on financial statement information which is generally easy to obtain. Depreciation, on the other hand, is the expensing of a fixed asset cost that was paid for when the asset was acquired.

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Operating cash flow

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

105) Interpret, in words, what the cash flow of the firm represents by discussing operating cash flow, changes in net working capital, and additions to fixed assets.

Answer: Operating cash flow is the cash flow a firm generates from its day-to-day operations. In other words, it is the cash flow generated as a result of putting the firm's assets to work. Changes in net working capital and fixed assets represent investments a firm needs for its operations. That is, a firm typically takes some of the cash flow it generates from using assets and reinvests it in new assets. Cash flow of the firm, then, is the cash flow a firm generates by employing its assets, net of any asset acquisitions.

Difficulty: 2 Medium

Section: 2.5 Cash Flow of the Firm

Topic: Cash flow from assets

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation

106) Why is cash flow management important?

Answer: Generally Accepted Accounting Principles (GAAP) allow significant subjective decisions to be made in many key areas. The use of cash flow as a metric to evaluate a company comes from the idea that there is less subjectivity involved and therefore, it is harder to spin the numbers.

Difficulty: 2 Medium

Section: 2.7 Cash Flow Management

Topic: Cash flows

Bloom's: Analyze

AACSB: Analytical Thinking

Accessibility: Keyboard Navigation