

Financial Statements and Cash Flow

Multiple Choice Questions

1. Assume both current and deferred taxes are positive values. Given this, deferred taxes will:
 - A. reduce the current tax expense and thus increase net income.
 - B. increase expenses and increase operating cash flows.
 - C. increase expenses and lower operating cash flows.
 - D. reduce net income but not affect the operating cash flows.
 - E. reduce both net income and operating cash flows.

2. Which one of these is handled differently in calculating cash flows for accounting versus financial purposes?
 - A. Change in net working capital
 - B. Depreciation expense
 - C. Interest expense
 - D. Deferred taxes
 - E. Dividends paid

3. Which one of these will increase earnings per share?
- A. Decreasing deferred taxes
 - B. Increasing depreciation expense
 - C. Lowering the operating income
 - D. Increasing the corporate tax rate
 - E. Lowering the percentage of net income added to retained earnings
4. A current asset is best defined as:
- A. the market value of all assets currently owned by the firm.
 - B. an asset the firm expects to purchase within the next year.
 - C. the amount of cash on hand the firm currently shows on its balance sheet.
 - D. cash and other assets owned by the firm that will convert to cash within the next year.
 - E. the value of fixed assets the firm expects to sell within the next year.
5. The long-term debts of a firm are liabilities:
- A. owed to the firm's shareholders.
 - B. that do not come due for at least 12 months.
 - C. owed to the firm's suppliers.
 - D. that come due within the next 12 months.
 - E. the firm expects to incur within the next 12 months.
6. A(n) ____ asset is one which can be quickly converted into cash without significant loss in value.
- A. tangible
 - B. fixed
 - C. intangible
 - D. liquid
 - E. long-term

7. Noncash items refer to:
- A. the credit sales of a firm.
 - B. the accounts payable of a firm.
 - C. all accounts on the balance sheet other than cash on hand.
 - D. the costs incurred for the purchase of intangible fixed assets.
 - E. expenses charged against revenues that do not directly affect cash flow.
8. Your ____ tax rate is the percentage of the next taxable dollar of income you earn that is payable as a tax.
- A. deductible
 - B. residual
 - C. marginal
 - D. average
 - E. total
9. Your ____ tax rate measures the total taxes you pay divided by your total taxable income.
- A. average
 - B. marginal
 - C. total
 - D. deductible
 - E. residual
10. ____ refers to the cash flow resulting from a firm's ongoing, normal business activities.
- A. Cash flow from assets
 - B. Net working capital
 - C. Capital spending
 - D. Cash flow from operating activities
 - E. Cash flow to creditors

11. ____ refers to the changes in net capital assets.

- A. Cash flow from assets
- B. Net working capital
- C. Cash flow from investing
- D. Operating cash flow
- E. Cash flow to creditors

12. ____ refers to the difference between a firm's current assets and its current liabilities.

- A. Operating cash flow
- B. Capital spending
- C. Net working capital
- D. Cash flow from assets
- E. Cash flow to creditors

13. ____ is calculated by adding back noncash expenses to earnings before interest and taxes, subtracting taxes, and adjusting for any changes in total assets or current liabilities that affect cash flows.

- A. Distributable cash flow
- B. Capital spending
- C. Cash flow from assets
- D. Cash flow from investing activities
- E. Cash flow to creditors

14. ____ refers to a firm's interest payments minus any net new borrowing.
- A. Operating cash flow
 - B. Distributable cash flow
 - C. Net working capital
 - D. Cash flow to equity investors
 - E. Cash flow to creditors
15. ____ refers to a firm's dividend payments minus any net new equity raised.
- A. Operating cash flow
 - B. Capital spending
 - C. Net working capital
 - D. Cash flow to equity investors
 - E. Cash flow from creditors
16. Which of the following are included in current assets?
- I. Equipment
 - II. Inventory
 - III. Accounts payable
 - IV. Cash
- A. II and IV only
 - B. I and III only
 - C. I, II, and IV only
 - D. III and IV only
 - E. II, III, and IV only

17. Which of the following are included in current liabilities?

- I. Debt payable to a mortgage company in nine months
- II. Note payable to a supplier in eighteen months
- III. Accounts payable to suppliers
- IV. Loan payable to a bank in fourteen months

- A. I and III only
- B. II and III only
- C. III and IV only
- D. II, III, and IV only
- E. I, II, and III only

18. Which one of the following accounts is generally the most liquid?

- A. Patent
- B. Building
- C. Accounts receivable
- D. Equipment
- E. Inventory

19. Which one of the following statements concerning liquidity is correct?

- A. Fixed assets are more liquid than current assets.
- B. Balance sheet accounts are listed in order of decreasing liquidity.
- C. Liquid assets tend to be highly profitable.
- D. The less liquidity a firm has, the lower the probability the firm will encounter financial difficulties.
- E. Trademarks and patents are highly liquid.

20. 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 current liabilities.
- D. generally associated with intangible assets.
- E. valuable to a firm even though liquid assets tend to be less profitable to own.

21. Book value is:

- A. based on historical cost.
- B. equivalent to market value for firms with fixed assets.
- C. more of a financial than an accounting valuation.
- D. the amount a willing buyer will pay for an asset.
- E. adjusted to market value whenever the market value exceeds the stated book value.

22. When making financial decisions related to assets, you should:

- A. place primary emphasis on historical costs.
- B. place more emphasis on book values than on market values.
- C. rely primarily on the value of assets as shown on the balance sheet.
- D. always consider market values.
- E. only consider market values if they are less than book values.

23. As seen on an income statement:

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

24. Depreciation:

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

25. When you are making a financial decision, the most relevant tax rate is the ____ rate.

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

26. Al's has a positive net income and a tax rate of 34 percent. Given this, an increase in which one of the following will cause the operating cash flow to increase?

- A. Fixed assets
- B. Taxes
- C. Net working capital
- D. Cost of goods sold
- E. Depreciation

27. A firm starts its year with a 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 might be positive, negative, or equal to zero.
 - 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 will be negative.
28. The cash flow to creditors increases when:
- A. cash is used to reduce accounts payable.
 - B. new shares of stock are sold for cash.
 - C. interest is paid on outstanding debt.
 - D. an asset is sold for cash.
 - E. a long-term debt is incurred.
29. Cash flow to stockholders must be positive when:
- A. the net sale of common stock exceeds the amount of dividends paid.
 - B. no income is distributed but new shares of stock are sold.
 - C. both the cash flow to assets and the cash flow to creditors are negative.
 - D. both the cash flow to assets and the cash flow to creditors are positive.
 - E. the dividends paid exceed the net new equity raised.
30. Which one of these, all else held constant, will increase the value of stockholders' equity?
- A. Decrease in accounts receivable
 - B. Increase in long-term debt
 - C. Decrease in retained earnings
 - D. Increase in accounts payable
 - E. Increase in fixed assets

31. Which one of these statements is correct?

- A. Long-term debt is the residual difference between assets and liabilities.
- B. Net income that is not paid out in dividends decreases retained earnings.
- C. Long-term debt requires a payout of cash within a stated time period.
- D. Stockholders' equity is stated at market value on the balance sheet.
- E. Stockholders' equity increases as the liquidity of a firm increases.

32. The carrying value or book value of assets:

- A. is always the best measure of a company's value to an investor.
- B. represents an average market value over time.
- C. is always higher than the replacement cost of the assets.
- D. is determined under GAAP and is based on the cost of the assets.
- E. is determined under GAPP and is based on the current market value of the assets.

33. When evaluating a balance sheet, a financial manager should consider which of the following?

- I. Value versus cost
- II. Debt versus equity
- III. Accounting liquidity

- A. I only
- B. I and III only
- C. II only
- D. I and II only
- E. I, II, and III

34. The income statement:

- A. measures a firm's performance as of a specific date.
- B. determines the aftertax income of a firm.
- C. excludes deferred taxes.
- D. includes dividends as an expense.
- E. determines the value of a firm to its shareholders.

35. What is the formula for computing operating cash flow?

- A. $\text{EBIT} + \text{Depreciation} - \text{Current taxes}$
- B. $\text{EBIT} + \text{Depreciation} - \text{Interest expense} - \text{Taxes}$
- C. $\text{EBIT} + \text{NWC} - \text{Depreciation}$
- D. $\text{EBIT} - \text{Depreciation} + \text{Current taxes}$
- E. $\text{EBIT} - \text{NWC} + \text{Depreciation} - \text{Current taxes}$

36. Net capital spending is equal to:

- A. the net purchases and sales of fixed assets.
- B. total cash flow to stockholders less interest and dividends paid.
- C. net income plus depreciation.
- D. the change in total assets.
- E. the change in current assets minus the change in current liabilities.

37. Cash flow to equity holders is defined as:

- A. the total dividends paid.
- B. the cash flow from assets plus the cash flow to creditors.
- C. cash dividends plus repurchases of equity minus new equity financing.
- D. repurchases of equity less cash dividends paid plus new equity sold.
- E. the net change in common stock and capital surplus.

38. Free cash flow is:

- A. without cost to the firm.
- B. equal to net income plus taxes.
- C. a term used to describe an increase in net working capital.
- D. cash that is available to distribute to creditors and equity holders.
- E. another term for operating cash flow.

39. The cash flow of a firm, also referred to as cash flow from assets, must be equal to the cash flow to:

- A. debt holders minus the cash flow to equity holders.
- B. equity holders plus the cash flow to debt holders.
- C. the government plus the cash flow to equity holders.
- D. equity holders minus the cash flow to debt holders.
- E. the government, the debt holders, and the equity holders.

40. A change in which one of these accounts will appear as an investing activity in an accounting statement of cash flows?

- A. Accounts payable
- B. Inventory
- C. Interest expense
- D. Fixed assets
- E. Sales

41. A firm has total equity of \$1,890, net working capital of \$150, long-term debt of \$890, and current liabilities of \$720. What is the amount of the net fixed assets?
- A. \$2,330
 - B. \$2,930
 - C. \$2,630
 - D. \$3,050
 - E. \$3,350
42. A firm has beginning retained earnings of \$4,200 and ending retained earnings of \$4,650. What is the amount of dividends paid if the firm earned a net income of \$1,950?
- A. \$450
 - B. \$1,950
 - C. \$2,400
 - D. \$1,500
 - E. \$900
43. Lester's has \$23,600 in sales, \$13,200 in cost of goods sold, \$2,300 in depreciation, \$900 in interest expense, and \$6,200 in selling, general, and administrative expenses. The firm owes no taxes for this year. What is the amount of the period costs that are included in the operating cash flow?
- A. \$19,400
 - B. \$7,000
 - C. \$9,300
 - D. \$20,300
 - E. \$6,200

44. A firm has \$800 in inventory, \$1,400 in fixed assets, \$500 in accounts receivables, \$100 in net working capital, and \$50 in cash. What is the amount of the current liabilities?
- A. \$3,750
 - B. \$1,350
 - C. \$3,950
 - D. \$1,150
 - E. \$1,250
45. Total assets are \$1,500, fixed assets are \$1,100, long-term debt is \$600, and short-term debt is \$300. What is the amount of net working capital?
- A. \$0
 - B. \$100
 - C. \$200
 - D. \$300
 - E. \$400
46. Brad's Company has equipment with a book value of \$500 that could be sold today at a 50 percent discount. Its inventory is valued at \$400 and could be sold to a competitor for that amount. The firm has \$50 in cash and customers owe them \$300. What is the accounting value of its liquid assets?
- A. \$50
 - B. \$350
 - C. \$700
 - D. \$750
 - E. \$1,000

47. Martha's Enterprises spent \$2,400 to purchase equipment three years ago. This equipment is currently valued at \$2,000 on today's balance sheet but could actually be sold for \$2,200. Net working capital is \$300 and long-term debt is \$1,100. Assuming the equipment is the firm's only fixed asset, what is the book value of shareholders' equity?

- A. \$1,000
- B. \$800
- C. \$1,200
- D. \$1,400
- E. \$1,600

48. Art's Boutique has sales of \$640,000 and costs of \$480,000. Interest expense is \$40,000 and depreciation is \$60,000. The tax rate is 34 percent. What is the net income?

- A. \$20,400
- B. \$39,600
- C. \$50,400
- D. \$79,200
- E. \$99,600

49. Given the tax rates as shown, what is the average tax rate for a firm with taxable income of \$126,500?

<u>Taxable Income</u>		<u>Tax Rate</u>
\$0 -	50,000	15%
50,001 -	75,000	25%
75,001 -	100,000	34%
100,001 -	335,000	39%

- A. 21.38%
- B. 23.88%
- C. 25.76%
- D. 34.64%
- E. 39.00%

50. The tax rates are as shown. Your firm currently has taxable income of \$74,000. How much additional tax will the firm owe if it increases its taxable income by \$25,000?

<u>Taxable Income</u>	<u>Tax Rate</u>
\$0 - 50,000	15%
50,001 - 75,000	25%
75,001 - 100,000	34%
100,001 - 335,000	39%

- A. \$9,700
B. \$8,500
C. \$6,250
D. \$7,560
E. \$8,410
51. Nel's Place has total sales of \$1,200, costs are \$715, and depreciation is \$145. The tax rate is 34 percent. The firm does not have any interest expense. What is the operating cash flow?
- A. \$93.08
B. \$224.40
C. \$310.60
D. \$369.40
E. \$600.60
52. Teddy's Pillows had beginning net fixed assets of \$600 and ending net fixed assets of \$730. Assets valued at \$400 were sold during the year. Depreciation was \$50. What is the amount of net capital spending?
- A. \$130
B. \$80
C. \$450
D. \$180
E. \$350

53. At the beginning of the year, a firm had current assets of \$360 and current liabilities of \$190. At the end of the year, the current assets are \$510 and the current liabilities are \$240. What is the change in net working capital?
- A. -\$30
 - B. -\$10
 - C. \$440
 - D. \$220
 - E. \$100
54. At the beginning of the year, long-term debt of a firm is \$270 and total debt is \$340. At the end of the year, long-term debt is \$290 and total debt is \$390. The interest paid is \$70. What is the amount of the cash flow to creditors?
- A. -\$50
 - B. -\$120
 - C. \$20
 - D. \$50
 - E. \$60
55. Pete's Boats has beginning long-term debt of \$180 and ending long-term debt of \$210. The beginning and ending total debt balances are \$340 and \$360, respectively. The interest paid is \$30. What is the amount of the cash flow to creditors?
- A. -\$10
 - B. \$0
 - C. \$10
 - D. \$40
 - E. \$50

56. Peggy Grey's Cookies has net income of \$360. The firm pays out 50 percent of the net income to its shareholders as dividends. During the year, the company sold \$44 worth of common stock. What is the cash flow to stockholders?
- A. \$64
 - B. \$136
 - C. \$144
 - D. \$224
 - E. \$296
57. Thompson's Jet Skis has operating cash flow of \$258. Depreciation is \$45 and interest paid is \$53. A net total of \$79 was paid on long-term debt. The firm spent \$210 on fixed assets and increased net working capital by \$48. What is the amount of the cash flow to stockholders?
- A. -\$104
 - B. -\$132
 - C. \$28
 - D. \$114
 - E. \$142

58.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
Cash	\$ 298	\$ 306	Accounts payable	\$ 6,219	\$ 6,184
Accounts receivable	3,006	3,422	Accrued expenses	<u>1,880</u>	<u>1,625</u>
Inventory	<u>5,210</u>	<u>5,650</u>	Total	<u>\$ 8,099</u>	<u>\$ 7,809</u>
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the change in the net working capital from 2013 to 2014?

- A. \$1,235
- B. \$1,035
- C. \$1,154
- D. \$1,984
- E. \$1,569

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What is the average tax rate for 2014?

- A. 34.00%
- B. 34.21%
- C. 35.02%
- D. 35.00%
- E. 30.32%

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What is the amount of the net capital spending for 2014?

- A. \$3,517
- B. \$5,451
- C. \$4,484
- D. \$3,620
- E. \$4,587

61.

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What is the amount of net working capital for 2014?

- A. \$415
- B. \$1,154
- C. \$1,569
- D. \$1,734
- E. \$734

62.

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What is the cash flow of the firm, or (CF(A)), for 2014?

- A. -\$1,273
- B. -\$3,581
- C. \$1,273
- D. \$2,160
- E. \$3,414

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Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the amount of net new borrowing for 2014?

- A. \$3,750
- B. \$3,250
- C. \$3,360
- D. \$4,040
- E. \$3,480

64.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
Cash	\$ 298	\$ 306	Accounts payable	\$ 6,219	\$ 6,184
Accounts receivable	3,006	3,422	Accrued expenses	<u>1,880</u>	<u>1,625</u>
Inventory	<u>5,210</u>	<u>5,650</u>	Total	<u>\$ 8,099</u>	<u>\$ 7,809</u>
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the cash flow to creditors for 2014?

- A. -\$3,650
- B. -\$4,040
- C. -\$3,350
- D. -\$4,270
- E. -\$3,810

65.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the net working capital for 2014?

- A. \$28
- B. \$34
- C. \$2,012
- D. \$744
- E. \$772

66.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the amount of the additions to net working capital?

- A. \$28
- B. \$46
- C. -\$28
- D. -\$46
- E. -\$98

67.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is net capital spending for 2014?

- A. \$1,115
- B. \$2,130
- C. -\$28
- D. \$0
- E. \$2,105

68.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the operating cash flow for 2014?

- A. \$1,690
- B. \$1,955
- C. \$2,645
- D. \$595
- E. \$2,300

69.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the cash flow of the firm, CF(A), for 2014?

- A. \$150
- B. \$113
- C. \$297
- D. -\$147
- E. -\$203

70.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is net new borrowing for 2014?

- A. \$665
- B. \$635
- C. \$385
- D. \$915
- E. \$650

71.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the cash flow to creditors, CF(B), for 2014?

- A. \$385
- B. -\$915
- C. -\$385
- D. \$265
- E. \$915

72.	Lazy Day, Inc.	<u>2013</u>	<u>2014</u>
	Cash	\$ 85	\$ 88
	Sales	9,870	10,360
	Inventory	1,220	1,340
	Depreciation	990	1,015
	Cost of goods sold	4,920	5,210
	Accounts payable	1,170	1,240
	Long-term debt	3,500	4,150
	Shareholders' equity	3,734	4,227
	Accounts receivable	609	584
	Fixed assets	6,490	7,605
	Interest expense	250	265
	Selling and general expenses	2,570	2,850
	Taxes	520	345

What is the cash flow to stockholders, CF(S), for 2014?

- A. \$588
- B. \$493
- C. \$182
- D. -\$428
- E. \$1,168

73.	<u>2014</u>
Cost of goods sold	\$6,220
Depreciation	890
Interest	460
Dividends paid	140
Selling and general expenses	1,950
Addition to retained earnings	330
Tax rate	34%

What is the taxable income for 2014?

- A. \$629.80
- B. \$500.00
- C. \$187.60
- D. \$712.12
- E. \$470.00

74.	<u>2014</u>
Cost of goods sold	\$6,220
Depreciation	890
Interest	460
Dividends paid	140
Selling and general expenses	1,950
Addition to retained earnings	330
Tax rate	34%

What is the operating cash flow for 2014?

- A. \$1,423.14
- B. \$2,072.12
- C. \$1,820.00
- D. \$1,250.00
- E. \$1,360.00

75.	<u>2014</u>
Cost of goods sold	\$6,220
Depreciation	890
Interest	460
Dividends paid	140
Selling and general expenses	1,950
Addition to retained earnings	330
Tax rate	34%

What are the sales for 2014?

- A. \$9,584.24
- B. \$4,385.76
- C. \$10,232.12
- D. \$4,815.00
- E. \$10,474.24

76.	<u>2014</u>
Cost of goods sold	\$6,220
Depreciation	890
Interest	460
Dividends paid	140
Selling and general expenses	1,950
Addition to retained earnings	330
Tax rate	34%

Assume sales are \$1,780; cost of goods sold is \$545, general expenses are \$100, depreciation expense is \$185, interest paid is \$35, and the tax rate is 35 percent. What is the net income amount?

- A. \$779.75
- B. \$615.30
- C. \$594.75
- D. \$320.25
- E. \$575.25

77.	<u>2014</u>
Cost of goods sold	\$5,920.00
Addition to retained earnings	587.50
Net income	1,137.50
Interest	270.00
Depreciation	1,100.00
Selling and general expenses	1,440.00
Tax rate	35%

What is the taxable income for 2014?

- A. \$1,380.45
- B. \$1,805.62
- C. \$1,640.25
- D. \$1,535.63
- E. \$1,750.00

78.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

What is the operating cash flow for 2014?

- A. \$2,225.50
- B. \$2,850.00
- C. \$2,020.00
- D. \$2,507.50
- E. \$2,354.55

79.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

What is the amount of dividends paid in 2014?

- A. \$0
- B. \$1,162.50
- C. \$550.00
- D. \$1,725.00
- E. \$950.00

80.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

Assume sales are \$900, cost of goods sold is \$450, depreciation expense is \$80, interest paid is \$40, selling and general expenses are \$220, dividends paid is \$10, and the tax rate is 34 percent. What is the addition to retained earnings?

- A. \$82.60
- B. \$62.60
- C. \$66.00
- D. \$79.20
- E. \$102.60

Essay Questions

81. Identify three items that are included on an income statement but excluded from operating cash flows. Explain the reason for each exclusion.

82. Identify three cash flows that occur between a firm and its stockholders. Indicate the direction of the cash flow in each case.

83. Why is depreciation added as a part of the capital spending formula?

84. Discuss the difference between the book value and market value of assets and explain which is more important to the financial manager and why.

85. Interpret, in words, what cash flow of the firm, or $CF(A)$, represents by discussing operating cash flow, changes in net working capital, and additions to fixed assets.

Chapter 02 Financial Statements and Cash Flow Answer Key

Multiple Choice Questions

1. Assume both current and deferred taxes are positive values. Given this, deferred taxes will:

- A. reduce the current tax expense and thus increase net income.
- B. increase expenses and increase operating cash flows.
- C. increase expenses and lower operating cash flows.
- D. reduce net income but not affect the operating cash flows.
- E. reduce both net income and operating cash flows.

Difficulty Level: 2 Medium

Topic: Deferred Taxes

2. Which one of these is handled differently in calculating cash flows for accounting versus financial purposes?

- A. Change in net working capital
- B. Depreciation expense
- C. Interest expense
- D. Deferred taxes
- E. Dividends paid

Difficulty Level: 1 Easy

Topic: Accounting versus Financial Cash Flows

3. Which one of these will increase earnings per share?

- A. Decreasing deferred taxes
- B. Increasing depreciation expense
- C. Lowering the operating income
- D. Increasing the corporate tax rate
- E. Lowering the percentage of net income added to retained earnings

Difficulty Level: 2 Medium

Topic: Earnings per share

4. A current asset is best defined as:

- A. the market value of all assets currently owned by the firm.
- B. an asset the firm expects to purchase within the next year.
- C. the amount of cash on hand the firm currently shows on its balance sheet.
- D. cash and other assets owned by the firm that will convert to cash within the next year.
- E. the value of fixed assets the firm expects to sell within the next year.

Difficulty Level: 1 Easy

Topic: Current Asset

5. The long-term debts of a firm are liabilities:

- A. owed to the firm's shareholders.
- B. that do not come due for at least 12 months.
- C. owed to the firm's suppliers.
- D. that come due within the next 12 months.
- E. the firm expects to incur within the next 12 months.

Difficulty Level: 1 Easy

Topic: Long-Term Debt

6. A(n) ____ asset is one which can be quickly converted into cash without significant loss in value.

- A. tangible
- B. fixed
- C. intangible
- D. liquid
- E. long-term

Difficulty Level: 1 Easy

Topic: Liquid Assets

7. Noncash items refer to:

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

Difficulty Level: 1 Easy

Topic: Noncash Items

8. Your ____ tax rate is the percentage of the next taxable dollar of income you earn that is payable as a tax.

- A. deductible
- B. residual
- C. marginal
- D. average
- E. total

Difficulty Level: 1 Easy

Topic: Marginal Tax Rate

9. Your ____ tax rate measures the total taxes you pay divided by your total taxable income.

- A. average
- B. marginal
- C. total
- D. deductible
- E. residual

Difficulty Level: 1 Easy
Topic: Average Tax Rates

10. ____ refers to the cash flow resulting from a firm's ongoing, normal business activities.

- A. Cash flow from assets
- B. Net working capital
- C. Capital spending
- D. Cash flow from operating activities
- E. Cash flow to creditors

Difficulty Level: 2 Medium
Topic: Cash Flow from Operating Activities

11. ____ refers to the changes in net capital assets.

- A. Cash flow from assets
- B. Net working capital
- C. Cash flow from investing
- D. Operating cash flow
- E. Cash flow to creditors

Difficulty Level: 2 Medium
Topic: Cash Flow from Investing

12. ____ refers to the difference between a firm's current assets and its current liabilities.

- A. Operating cash flow
- B. Capital spending
- C. Net working capital
- D. Cash flow from assets
- E. Cash flow to creditors

Difficulty Level: 1 Easy
Topic: Net Working Capital

13. ____ is calculated by adding back noncash expenses to earnings before interest and taxes, subtracting taxes, and adjusting for any changes in total assets or current liabilities that affect cash flows.

- A. Distributable cash flow
- B. Capital spending
- C. Cash flow from assets
- D. Cash flow from investing activities
- E. Cash flow to creditors

Difficulty Level: 2 Medium
Topic: Distributable cash flow

14. ____ refers to a firm's interest payments minus any net new borrowing.

- A. Operating cash flow
- B. Distributable cash flow
- C. Net working capital
- D. Cash flow to equity investors
- E. Cash flow to creditors

Difficulty Level: 1 Easy
Topic: Cash Flow to Creditors

15. ____ refers to a firm's dividend payments minus any net new equity raised.

- A. Operating cash flow
- B. Capital spending
- C. Net working capital
- D. Cash flow to equity investors
- E. Cash flow from creditors

Difficulty Level: 1 Easy

Topic: Cash Flow to Equity Investors

16. Which of the following are included in current assets?

- I. Equipment
- II. Inventory
- III. Accounts payable
- IV. Cash

- A. II and IV only
- B. I and III only
- C. I, II, and IV only
- D. III and IV only
- E. II, III, and IV only

Difficulty Level: 1 Easy

Topic: Current Asset

17. Which of the following are included in current liabilities?

- I. Debt payable to a mortgage company in nine months
- II. Note payable to a supplier in eighteen months
- III. Accounts payable to suppliers
- IV. Loan payable to a bank in fourteen months

- A. I and III only
- B. II and III only
- C. III and IV only
- D. II, III, and IV only
- E. I, II, and III only

Difficulty Level: 2 Medium

Topic: Current Liabilities

18. Which one of the following accounts is generally the most liquid?

- A. Patent
- B. Building
- C. Accounts receivable
- D. Equipment
- E. Inventory

Difficulty Level: 1 Easy

Topic: Liquidity

19. Which one of the following statements concerning liquidity is correct?

- A. Fixed assets are more liquid than current assets.
- B. Balance sheet accounts are listed in order of decreasing liquidity.
- C. Liquid assets tend to be highly profitable.
- D. The less liquidity a firm has, the lower the probability the firm will encounter financial difficulties.
- E. Trademarks and patents are highly liquid.

Difficulty Level: 1 Easy

Topic: Liquidity

20. 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 current liabilities.
- D. generally associated with intangible assets.
- E. valuable to a firm even though liquid assets tend to be less profitable to own.

Difficulty Level: 1 Easy

Topic: Liquidity

21. Book value is:

- A. based on historical cost.
- B. equivalent to market value for firms with fixed assets.
- C. more of a financial than an accounting valuation.
- D. the amount a willing buyer will pay for an asset.
- E. adjusted to market value whenever the market value exceeds the stated book value.

Difficulty Level: 1 Easy

Topic: Book Value

22. When making financial decisions related to assets, you should:

- A. place primary emphasis on historical costs.
- B. place more emphasis on book values than on market values.
- C. rely primarily on the value of assets as shown on the balance sheet.
- D. always consider market values.
- E. only consider market values if they are less than book values.

Difficulty Level: 1 Easy

Topic: Market Value

23. As seen on an income statement:

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

Difficulty Level: 2 Medium

Topic: Income Statement

24. Depreciation:

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

Difficulty Level: 2 Medium

Topic: Noncash Items

25. When you are making a financial decision, the most relevant tax rate is the ____ rate.

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

Difficulty Level: 1 Easy
Topic: Marginal Tax Rate

26. Al's has a positive net income and a tax rate of 34 percent. Given this, an increase in which one of the following will cause the operating cash flow to increase?

- A. Fixed assets
- B. Taxes
- C. Net working capital
- D. Cost of goods sold
- E. Depreciation

Difficulty Level: 2 Medium
Topic: Operating Cash Flow

27. A firm starts its year with a 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 might be positive, negative, or equal to zero.
- 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 will be negative.

Difficulty Level: 2 Medium
Topic: Change in Net Working Capital

28. The cash flow to creditors increases when:

- A. cash is used to reduce accounts payable.
- B. new shares of stock are sold for cash.
- C. interest is paid on outstanding debt.
- D. an asset is sold for cash.
- E. a long-term debt is incurred.

Difficulty Level: 1 Easy
Topic: Cash Flow to Creditors

29. Cash flow to stockholders must be positive when:

- A. the net sale of common stock exceeds the amount of dividends paid.
- B. no income is distributed but new shares of stock are sold.
- C. both the cash flow to assets and the cash flow to creditors are negative.
- D. both the cash flow to assets and the cash flow to creditors are positive.
- E. the dividends paid exceed the net new equity raised.

Difficulty Level: 2 Medium
Topic: Cash Flow to Stockholders

30. Which one of these, all else held constant, will increase the value of stockholders' equity?

- A. Decrease in accounts receivable
- B. Increase in long-term debt
- C. Decrease in retained earnings
- D. Increase in accounts payable
- E. Increase in fixed assets

Difficulty Level: 2 Medium
Topic: Balance Sheet

31. Which one of these statements is correct?

- A. Long-term debt is the residual difference between assets and liabilities.
- B. Net income that is not paid out in dividends decreases retained earnings.
- C. Long-term debt requires a payout of cash within a stated time period.
- D. Stockholders' equity is stated at market value on the balance sheet.
- E. Stockholders' equity increases as the liquidity of a firm increases.

Difficulty Level: 2 Medium

Topic: Balance Sheet

32. The carrying value or book value of assets:

- A. is always the best measure of a company's value to an investor.
- B. represents an average market value over time.
- C. is always higher than the replacement cost of the assets.
- D. is determined under GAAP and is based on the cost of the assets.
- E. is determined under GAPP and is based on the current market value of the assets.

Difficulty Level: 2 Medium

Topic: Carrying Value

33. When evaluating a balance sheet, a financial manager should consider which of the following?

- I. Value versus cost
- II. Debt versus equity
- III. Accounting liquidity

- A. I only
- B. I and III only
- C. II only
- D. I and II only
- E. I, II, and III

Difficulty Level: 2 Medium

Topic: Balance Sheet

34. The income statement:

- A. measures a firm's performance as of a specific date.
- B.** determines the aftertax income of a firm.
- C. excludes deferred taxes.
- D. includes dividends as an expense.
- E. determines the value of a firm to its shareholders.

Difficulty Level: 2 Medium

Topic: Income Statement

35. What is the formula for computing operating cash flow?

- A.** EBIT + Depreciation - Current taxes
- B. EBIT + Depreciation - Interest expense - Taxes
- C. EBIT + NWC - Depreciation
- D. EBIT - Depreciation + Current taxes
- E. EBIT - NWC + Depreciation - Current taxes

Difficulty Level: 2 Medium

Topic: Operating Cash Flow

36. Net capital spending is equal to:

- A.** the net purchases and sales of fixed assets.
- B. total cash flow to stockholders less interest and dividends paid.
- C. net income plus depreciation.
- D. the change in total assets.
- E. the change in current assets minus the change in current liabilities.

Difficulty Level: 2 Medium

Topic: Net Capital Spending

37. Cash flow to equity holders is defined as:

- A. the total dividends paid.
- B. the cash flow from assets plus the cash flow to creditors.
- C. cash dividends plus repurchases of equity minus new equity financing.
- D. repurchases of equity less cash dividends paid plus new equity sold.
- E. the net change in common stock and capital surplus.

Difficulty Level: 2 Medium

Topic: Cash Flow to Equity Holders

38. Free cash flow is:

- A. without cost to the firm.
- B. equal to net income plus taxes.
- C. a term used to describe an increase in net working capital.
- D. cash that is available to distribute to creditors and equity holders.
- E. another term for operating cash flow.

Difficulty Level: 2 Medium

Topic: Free Cash Flow

39. The cash flow of a firm, also referred to as cash flow from assets, must be equal to the cash flow to:

- A. debt holders minus the cash flow to equity holders.
- B. equity holders plus the cash flow to debt holders.
- C. the government plus the cash flow to equity holders.
- D. equity holders minus the cash flow to debt holders.
- E. the government, the debt holders, and the equity holders.

Difficulty Level: 2 Medium

Topic: Cash Flow

40. A change in which one of these accounts will appear as an investing activity in an accounting statement of cash flows?

- A. Accounts payable
- B. Inventory
- C. Interest expense
- D. Fixed assets
- E. Sales

Difficulty Level: 2 Medium

Topic: Statement of Cash Flows

41. A firm has total equity of \$1,890, net working capital of \$150, long-term debt of \$890, and current liabilities of \$720. What is the amount of the net fixed assets?

- A. \$2,330
- B. \$2,930
- C. \$2,630
- D. \$3,050
- E. \$3,350

Net fixed assets = $\$890 + 1,890 - 150 = \$2,630$

Difficulty Level: 2 Medium

Topic: Balance Sheet

42. A firm has beginning retained earnings of \$4,200 and ending retained earnings of \$4,650. What is the amount of dividends paid if the firm earned a net income of \$1,950?

A. \$450
B. \$1,950
C. \$2,400
D. \$1,500
E. \$900

$$\text{Dividends paid} = \$1,950 - (\$4,650 - 4,200) = \$1,500$$

Difficulty Level: 2 Medium

Topic: Dividends paid

43. Lester's has \$23,600 in sales, \$13,200 in cost of goods sold, \$2,300 in depreciation, \$900 in interest expense, and \$6,200 in selling, general, and administrative expenses. The firm owes no taxes for this year. What is the amount of the period costs that are included in the operating cash flow?

A. \$19,400
B. \$7,000
C. \$9,300
D. \$20,300
E. \$6,200

$$\text{Period costs} = \text{Selling, general, and administrative expenses} = \$6,200$$

Cost of goods sold is a product cost, depreciation is a non-cash expense, and interest expense is a cash flow to creditors.

Difficulty Level: 2 Medium

Topic: Period Costs and Operating Cash Flow

44. A firm has \$800 in inventory, \$1,400 in fixed assets, \$500 in accounts receivables, \$100 in net working capital, and \$50 in cash. What is the amount of the current liabilities?

A. \$3,750
B. \$1,350
C. \$3,950
D. \$1,150
E. \$1,250

$$\text{Current liabilities} = (\$50 + 500 + 800) - \$100 = \$1,250$$

Difficulty Level: 2 Medium
Topic: Net Working Capital

45. Total assets are \$1,500, fixed assets are \$1,100, long-term debt is \$600, and short-term debt is \$300. What is the amount of net working capital?

A. \$0
B. \$100
C. \$200
D. \$300
E. \$400

$$\text{Net working capital} = (\$1,500 - 1,100) - \$300 = \$100$$

Difficulty Level: 2 Medium
Topic: Net Working Capital

46. Brad's Company has equipment with a book value of \$500 that could be sold today at a 50 percent discount. Its inventory is valued at \$400 and could be sold to a competitor for that amount. The firm has \$50 in cash and customers owe them \$300. What is the accounting value of its liquid assets?

A. \$50
B. \$350
C. \$700
D. \$750
E. \$1,000

$$\text{Liquid assets} = \$400 + 50 + 300 = \$750$$

Difficulty Level: 2 Medium

Topic: Liquidity

47. Martha's Enterprises spent \$2,400 to purchase equipment three years ago. This equipment is currently valued at \$2,000 on today's balance sheet but could actually be sold for \$2,200. Net working capital is \$300 and long-term debt is \$1,100. Assuming the equipment is the firm's only fixed asset, what is the book value of shareholders' equity?

A. \$1,000
B. \$800
C. \$1,200
D. \$1,400
E. \$1,600

$$\text{Book value of shareholders' equity} = \$2,000 + 300 - 1,100 = \$1,200$$

Difficulty Level: 2 Medium

Topic: Book Value

48. Art's Boutique has sales of \$640,000 and costs of \$480,000. Interest expense is \$40,000 and depreciation is \$60,000. The tax rate is 34 percent. What is the net income?

- A. \$20,400
- B. \$39,600**
- C. \$50,400
- D. \$79,200
- E. \$99,600

$$\text{Taxable income} = (\$640,000 - 480,000 - 40,000 - 60,000)(1 - .34) = \$39,600$$

Difficulty Level: 2 Medium

Topic: Net Income

49. Given the tax rates as shown, what is the average tax rate for a firm with taxable income of \$126,500?

<u>Taxable Income</u>		<u>Tax Rate</u>
\$0 -	50,000	15%
50,001 -	75,000	25%
75,001 -	100,000	34%
100,001 -	335,000	39%

- A. 21.38%
- B. 23.88%
- C. 25.76%**
- D. 34.64%
- E. 39.00%

$$\text{Tax} = .15(\$50,000) + .25(\$25,000) + .34(\$25,000) + .39(\$126,500 - 100,000) = \$32,585$$

$$\text{Average tax rate} = \$32,585/\$126,500 = .2576, \text{ or } 25.76\%$$

Difficulty Level: 2 Medium

Topic: Marginal Tax Rate

50. The tax rates are as shown. Your firm currently has taxable income of \$74,000. How much additional tax will the firm owe if it increases its taxable income by \$25,000?

<u>Taxable Income</u>	<u>Tax Rate</u>
\$0 - 50,000	15%
50,001 - 75,000	25%
75,001 - 100,000	34%
100,001 - 335,000	39%

- A. \$9,700
- B. \$8,500
- C. \$6,250
- D. \$7,560
- E. \$8,410

$$\text{Additional tax} = .25(\$1,000) + .34(\$24,000) = \$8,410$$

Difficulty Level: 2 Medium

Topic: Taxes

51. Nel's Place has total sales of \$1,200, costs are \$715, and depreciation is \$145. The tax rate is 34 percent. The firm does not have any interest expense. What is the operating cash flow?

- A. \$93.08
- B. \$224.40
- C. \$310.60
- D. \$369.40
- E. \$600.60

$$\text{Earnings before interest and taxes} = \$1,200 - 715 - 145 = \$340$$

$$\text{Tax} = .34(\$340) = \$115.60$$

$$\text{Operating cash flow} = \$340 + 145 - 115.60 = \$369.40$$

Difficulty Level: 2 Medium

Topic: Operating Cash Flow

52. Teddy's Pillows had beginning net fixed assets of \$600 and ending net fixed assets of \$730. Assets valued at \$400 were sold during the year. Depreciation was \$50. What is the amount of net capital spending?

A. \$130
B. \$80
C. \$450
D. \$180
E. \$350

$$\text{Net capital spending} = \$730 - 600 + 50 = \$180$$

Difficulty Level: 2 Medium

Topic: Net Capital Spending

53. At the beginning of the year, a firm had current assets of \$360 and current liabilities of \$190. At the end of the year, the current assets are \$510 and the current liabilities are \$240. What is the change in net working capital?

A. -\$30
B. -\$10
C. \$440
D. \$220
E. \$100

$$\text{Change in net working capital} = (\$510 - 240) - (\$360 - 190) = \$100$$

Difficulty Level: 2 Medium

Topic: Change in Net Working Capital

54. At the beginning of the year, long-term debt of a firm is \$270 and total debt is \$340. At the end of the year, long-term debt is \$290 and total debt is \$390. The interest paid is \$70. What is the amount of the cash flow to creditors?

A. -\$50
B. -\$120
C. \$20
D. \$50
E. \$60

$$\text{Cash flow to creditors} = \$70 - (\$290 - 270) = \$50$$

Difficulty Level: 2 Medium
Topic: Cash Flow to Creditors

55. Pete's Boats has beginning long-term debt of \$180 and ending long-term debt of \$210. The beginning and ending total debt balances are \$340 and \$360, respectively. The interest paid is \$30. What is the amount of the cash flow to creditors?

A. -\$10
B. \$0
C. \$10
D. \$40
E. \$50

$$\text{Cash flow to creditors} = \$30 - (\$210 - 180) = \$0$$

Difficulty Level: 2 Medium
Topic: Cash Flow to Creditors

56. Peggy Grey's Cookies has net income of \$360. The firm pays out 50 percent of the net income to its shareholders as dividends. During the year, the company sold \$44 worth of common stock. What is the cash flow to stockholders?

A. \$64
B. \$136
C. \$144
D. \$224
E. \$296

Cash flow to stockholders = $.50(\$360) - \$44 = \$136$

Difficulty Level: 2 Medium
Topic: Cash Flow to Stockholders

57. Thompson's Jet Skis has operating cash flow of \$258. Depreciation is \$45 and interest paid is \$53. A net total of \$79 was paid on long-term debt. The firm spent \$210 on fixed assets and increased net working capital by \$48. What is the amount of the cash flow to stockholders?

A. -\$104
B. -\$132
C. \$28
D. \$114
E. \$142

$CF(A) = \$258 - 48 - 210 = \0 ; $CF(B) = \$53 - (-\$79) = \$132$; $CF(S) = \$0 - 132 = -\132

Difficulty Level: 2 Medium
Topic: Cash Flow to Stockholders

58.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
Cash	\$ 298	\$ 306	Accounts payable	\$ 6,219	\$ 6,184
Accounts receivable	3,006	3,422	Accrued expenses	<u>1,880</u>	<u>1,625</u>
Inventory	<u>5,210</u>	<u>5,650</u>	Total	\$ 8,099	\$ 7,809
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the change in the net working capital from 2013 to 2014?

- A. \$1,235
- B. \$1,035
- C. \$1,154
- D. \$1,984
- E. \$1,569

$$\text{Change in net working capital} = (\$9,378 - 7,809) - (\$8,514 - 8,099) = \$1,154$$

Difficulty Level: 2 Medium
Topic: Change in Net Working Capital

59.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
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Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
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Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the average tax rate for 2014?

- A. 34.00%
- B. 34.21%
- C. 35.02%
- D. 35.00%
- E. 30.32%

Average tax rate = $\$519/\$1,482 = .3502$, or 35.02%

Difficulty Level: 2 Medium

Topic: Average Tax Rates

60.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
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Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
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Inventory	<u>5,210</u>	<u>5,650</u>	Total	<u>\$ 8,099</u>	<u>\$ 7,809</u>
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the amount of the net capital spending for 2014?

- A. \$3,517
- B. \$5,451
- C. \$4,484
- D. \$3,620
- E. \$4,587

$$\text{Net capital spending} = \$36,400 - 32,780 + 967 = \$4,587$$

Difficulty Level: 2 Medium
Topic: Net Capital Spending

61.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
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Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the amount of net working capital for 2014?

- A. \$415
- B. \$1,154
- C. \$1,569
- D. \$1,734
- E. \$734

Net working capital for 2014 = \$9,378 - 7,809 = \$1,569

Difficulty Level: 2 Medium
Topic: Net Working Capital

62.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
Cash	\$ 298	\$ 306	Accounts payable	\$ 6,219	\$ 6,184
Accounts receivable	3,006	3,422	Accrued expenses	<u>1,880</u>	<u>1,625</u>
Inventory	<u>5,210</u>	<u>5,650</u>	Total	<u>\$ 8,099</u>	<u>\$ 7,809</u>
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the cash flow of the firm, or (CF(A)), for 2014?

- A. -\$1,273
- B. -\$3,581**
- C. \$1,273
- D. \$2,160
- E. \$3,414

Operating cash flow = $\$1,712 + 967 - 519 = \$2,160$

Change in net working capital = $(\$9,378 - 7,809) - (\$8,514 - 8,099) = \$1,154$

Net capital spending = $\$36,400 - 32,780 + 967 = \$4,587$

Cash flow of the firm = $\$2,160 - 1,154 - 4,587 = -\$3,581$

Difficulty Level: 3 Hard
Topic: Cash Flow of the Firm

63.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
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Accounts receivable	3,006	3,422	Accrued expenses	<u>1,880</u>	<u>1,625</u>
Inventory	<u>5,210</u>	<u>5,650</u>	Total	<u>\$ 8,099</u>	<u>\$ 7,809</u>
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the amount of net new borrowing for 2014?

- A. \$3,750
- B. \$3,250
- C. \$3,360
- D. \$4,040
- E. \$3,480

$$\text{Net new borrowing} = \$21,991 - 17,951 = \$4,040$$

Difficulty Level: 2 Medium

Topic: Net New Borrowing

64.

Winslow, Inc.
2014 Income Statement

Net sales	\$11,418
Cost of goods sold	6,320
Selling, general, and administrative	2,419
Depreciation	<u>967</u>
Earnings before interest and taxes	\$ 1,712
Interest	<u>230</u>
Pretax income	\$ 1,482
Taxes	<u>519</u>
Net income	<u><u>\$ 963</u></u>

Winslow, Inc.
2013 and 2014 Balance Sheets

	<u>2013</u>	<u>2014</u>		<u>2013</u>	<u>2014</u>
Cash	\$ 298	\$ 306	Accounts payable	\$ 6,219	\$ 6,184
Accounts receivable	3,006	3,422	Accrued expenses	<u>1,880</u>	<u>1,625</u>
Inventory	<u>5,210</u>	<u>5,650</u>	Total	<u>\$ 8,099</u>	<u>\$ 7,809</u>
Total	<u>\$ 8,514</u>	<u>\$ 9,378</u>	Long-term debt	<u>\$17,951</u>	<u>\$21,991</u>
Fixed assets	<u>\$32,780</u>	<u>\$36,400</u>	Owners' equity	<u>\$15,244</u>	<u>\$15,978</u>
Total assets	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>	Total liab. & equity	<u><u>\$41,294</u></u>	<u><u>\$45,778</u></u>

What is the cash flow to creditors for 2014?

- A. -\$3,650
- B. -\$4,040
- C. -\$3,350
- D. -\$4,270
- E. -\$3,810

$$CF(B) = \$230 - (\$21,991 - 17,951) = -\$3,810$$

Difficulty Level: 2 Medium
Topic: Cash Flow to Creditors

65.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the net working capital for 2014?

- A. \$28
- B. \$34
- C. \$2,012
- D. \$744
- E. \$772

$$NWC_{2014} = \$88 + 584 + 1,340 - 1,240 = \$772$$

Difficulty Level: 2 Medium
Topic: Net Working Capital

66.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
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Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the amount of the additions to net working capital?

- A. \$28
- B. \$46
- C. -\$28
- D. -\$46
- E. -\$98

Additions to net working capital = $(\$88 + 584 + 1,340 - 1,240) - (\$85 + 609 + 1,220 - 1,170) =$
\$28

Difficulty Level: 2 Medium

Topic: Additions to Net Working Capital

67.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
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Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is net capital spending for 2014?

- A. \$1,115
- B.** \$2,130
- C. -\$28
- D. \$0
- E. \$2,105

$$NCS_{2014} = \$7,605 - 6,490 + 1,015 = \$2,130$$

Difficulty Level: 2 Medium
Topic: Net Capital Spending

68.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
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Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the operating cash flow for 2014?

A. \$1,690

B. \$1,955

C. \$2,645

D. \$595

E. \$2,300

$$\text{EBIT} = \$10,360 - 5,210 - 2,850 - 1,015 = \$1,285$$

$$\text{OCF} = \$1,285 + 1,015 - 345 = \$1,955$$

Difficulty Level: 3 Hard
Topic: Operating Cash Flow

69.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the cash flow of the firm, CF(A), for 2014?

- A. \$150
- B. \$113
- C. \$297
- D. -\$147
- E. -\$203

$$\text{EBIT} = \$10,360 - 5,210 - 2,850 - 1,015 = \$1,285$$

$$\text{Operating cash flow} = \$1,285 + 1,015 - 345 = \$1,955$$

$$\text{Additions to net working capital} = (\$88 + 584 + 1,340 - 1,240) - (\$85 + 609 + 1,220 - 1,170) = \$28$$

$$\text{Net capital spending} = \$7,605 - 6,490 + 1,015 = \$2,130$$

$$\text{CF(A)} = \$1,955 - 28 - 2,130 = -\$203$$

Difficulty Level: 3 Hard

Topic: Cash Flow of the Firm

70.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is net new borrowing for 2014?

- A. \$665
- B. \$635
- C. \$385
- D. \$915
- E. \$650

Net new borrowing = \$4,150 - 3,500 = \$650

Difficulty Level: 2 Medium

Topic: Net New Borrowing

71.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the cash flow to creditors, CF(B), for 2014?

- A. \$385
- B. -\$915
- C. -\$385
- D. \$265
- E. \$915

Cash flow to creditors or CF(B) = \$265 - (\$4,150 - 3,500) = -\$385

Difficulty Level: 2 Medium
Topic: Cash Flow to Creditors

72.

Lazy Day, Inc.

	<u>2013</u>	<u>2014</u>
Cash	\$ 85	\$ 88
Sales	9,870	10,360
Inventory	1,220	1,340
Depreciation	990	1,015
Cost of goods sold	4,920	5,210
Accounts payable	1,170	1,240
Long-term debt	3,500	4,150
Shareholders' equity	3,734	4,227
Accounts receivable	609	584
Fixed assets	6,490	7,605
Interest expense	250	265
Selling and general expenses	2,570	2,850
Taxes	520	345

What is the cash flow to stockholders, CF(S), for 2014?

- A. \$588
- B. \$493
- C. \$182
- D. -\$428
- E. \$1,168

$$\text{EBIT} = \$10,360 - 5,210 - 2,850 - 1,015 = \$1,285$$

$$\text{Operating cash flow} = \$1,285 + 1,015 - 345 = \$1,955$$

$$\text{Additions to net working capital} = (\$88 + 584 + 1,340 - 1,240) - (\$85 + 609 + 1,220 - 1,170) = \$28$$

$$\text{Net capital spending} = \$7,605 - 6,490 + 1,015 = \$2,130$$

$$\text{CF(A)} = \$1,955 - 28 - 2,130 = -\$203$$

$$\text{CF(B)} = \$265 - (\$4,150 - 3,500) = -\$385$$

$$\text{CF(S)} = -\$203 - (-\$385) = \$182$$

Difficulty Level: 3 Hard

Topic: Cash Flow to Stockholders

73.		<u>2014</u>
	Cost of goods sold	\$6,220
	Depreciation	890
	Interest	460
	Dividends paid	140
	Selling and general expenses	1,950
	Addition to retained earnings	330
	Tax rate	34%

What is the taxable income for 2014?

- A. \$629.80
- B. \$500.00
- C. \$187.60
- D. \$712.12
- E. \$470.00

Net income = $\$330 + 140 = \470

Taxable income = $\$470 / (1 - .34) = \712.12

Difficulty Level: 2 Medium

Topic: Taxable Income

74.		<u>2014</u>
	Cost of goods sold	\$6,220
	Depreciation	890
	Interest	460
	Dividends paid	140
	Selling and general expenses	1,950
	Addition to retained earnings	330
	Tax rate	34%

What is the operating cash flow for 2014?

- A. \$1,423.14
- B. \$2,072.12
- C. \$1,820.00
- D. \$1,250.00
- E. \$1,360.00

$$\text{Net income} = \$330 + 140 = \$470$$

$$\text{Taxable income} = \$470 / (1 - .34) = \$712.12$$

$$\text{Tax} = .34(\$712.12) = \$242.12$$

$$\text{Earnings before interest and taxes} = \$712.12 + 460 = \$1,172.12$$

$$\text{Operating cash flow} = \$1,172.12 + 890 - 242.12 = \$1,820.00$$

Difficulty Level: 3 Hard
Topic: Operating Cash Flow

75.		<u>2014</u>
	Cost of goods sold	\$6,220
	Depreciation	890
	Interest	460
	Dividends paid	140
	Selling and general expenses	1,950
	Addition to retained earnings	330
	Tax rate	34%

What are the sales for 2014?

- A. \$9,584.24
- B. \$4,385.76
- C. \$10,232.12
- D. \$4,815.00
- E. \$10,474.24

Net income = $\$330 + 140 = \470

Taxable income = $\$470 / (1 - .34) = \712.12

Earnings before interest and taxes = $\$712.12 + 460 = \$1,172.12$

Sales = $\$6,220 + 1,950 + 890 + 1,172.12 = \$10,232.12$

Difficulty Level: 2 Medium

Topic: Sales

76.		<u>2014</u>
	Cost of goods sold	\$6,220
	Depreciation	890
	Interest	460
	Dividends paid	140
	Selling and general expenses	1,950
	Addition to retained earnings	330
	Tax rate	34%

Assume sales are \$1,780; cost of goods sold is \$545, general expenses are \$100, depreciation expense is \$185, interest paid is \$35, and the tax rate is 35 percent. What is the net income amount?

- A. \$779.75
- B. \$615.30
- C. \$594.75
- D. \$320.25
- E. \$575.25

$$\text{Net Income} = (1 - .35)(\$1,780 - 545 - 100 - 185 - 35) = \$594.75$$

Difficulty Level: 2 Medium
Topic: Net Income

77.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

What is the taxable income for 2014?

- A. \$1,380.45
- B. \$1,805.62
- C. \$1,640.25
- D. \$1,535.63
- E. \$1,750.00

Taxable income = $\$1,137.50 / (1 - .35) = \$1,750.00$

Difficulty Level: 2 Medium
Topic: Taxable Income

78.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

What is the operating cash flow for 2014?

- A. \$2,225.50
- B. \$2,850.00
- C. \$2,020.00
- D. \$2,507.50
- E. \$2,354.55

Taxable income = $\$1,137.50 / (1 - .35) = \$1,750.00$

Taxes = $\$1,750 - 1,137.50 = \612.50

Earnings before interest and taxes = $\$1,750 + 270 = \$2,020$

Operating cash flow = $\$2,020 + 1,100 - 612.50 = \$2,507.50$

Difficulty Level: 3 Hard
Topic: Operating Cash Flow

79.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

What is the amount of dividends paid in 2014?

- A. \$0
- B. \$1,162.50
- C. \$550.00
- D. \$1,725.00
- E. \$950.00

Dividends paid = \$1,137.50 - 587.50 = \$550.00

Difficulty Level: 2 Medium
Topic: Dividends paid

80.		<u>2014</u>
	Cost of goods sold	\$5,920.00
	Addition to retained earnings	587.50
	Net income	1,137.50
	Interest	270.00
	Depreciation	1,100.00
	Selling and general expenses	1,440.00
	Tax rate	35%

Assume sales are \$900, cost of goods sold is \$450, depreciation expense is \$80, interest paid is \$40, selling and general expenses are \$220, dividends paid is \$10, and the tax rate is 34 percent. What is the addition to retained earnings?

- A. \$82.60
- B.** \$62.60
- C. \$66.00
- D. \$79.20
- E. \$102.60

Net income = $(1 - .34)(\$900 - 450 - 220 - 80 - 40) = \72.60

Addition to retained earnings = $\$72.60 - 10 = \62.60

Difficulty Level: 2 Medium

Topic: Net Income

Essay Questions

81. Identify three items that are included on an income statement but excluded from operating cash flows. Explain the reason for each exclusion.

The three items are:

- 1) Depreciation: Depreciation is a non-cash expense.
- 2) Deferred taxes: Deferred taxes is a non-cash expense.
- 3) Interest expense: Interest expense is a cost of financing, not an operating expense.

Difficulty Level: 3 Hard
Topic: Operating Cash Flow

82. Identify three cash flows that occur between a firm and its stockholders. Indicate the direction of the cash flow in each case.

The three cash flows are:

- 1) Sale of equity securities: Cash inflow to the firm
- 2) Repurchase of outstanding securities: Cash outflow from the firm
- 3) Dividends paid: Cash outflow from the firm

Difficulty Level: 3 Hard
Topic: Cash Flow to Stockholders

83. Why is depreciation added as a part of the capital spending formula?

The purpose of the capital spending formula is to determine the net fixed asset purchases, or purchases minus dispositions, for the period. Since depreciation expense lowers the ending net fixed asset balance, depreciation must be added back to offset that decrease. Once the depreciation expense has been offset, then the net fixed asset purchases is just the difference between the ending and beginning account values.

Difficulty Level: 2 Medium

Topic: Operating Cash Flow

84. Discuss the difference between the book value and market value of assets and explain which is more important to the financial manager and why.

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, the financial manager should focus on the firm's stock price, which is a market value measure. Hence, market values are more meaningful than book values.

Difficulty Level: 3 Hard

Topic: Book Value and Market Value

85. Interpret, in words, what cash flow of the firm, or $CF(A)$, represents by discussing operating cash flow, changes in net working capital, and additions to fixed assets.

Operating cash flow is the cash flow a firm generates from its day-to-day operations. In other words, it is the cash inflow generated as a result of putting the firm's assets to work. Changes in net working capital and fixed assets represent investments a firm makes in these assets. 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 acquisitions.

Difficulty Level: 3 Hard
Topic: Cash Flow of the Firm