Exam

Name___________________________________

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) All of the following are uses of cash EXCEPT 1) _______

A) dividends.
B) an increase in inventory.
C) a decrease in cash.
D) a decrease in notes payable.

Answer: C

Explanation: A)
B)
C)
D)

FIGURE 2.1

A corporation had the following earnings and loss record for the years 1997 through 2002:

1997	$200,000
1998	100,000
1999	100,000
2000	(800,000)
2001	200,000
2002	300,000

2) In 2002 the corporation in Figure 2.1 will have taxable income of 2) _______

A) $100,000
B) $0
C) $300,000
D) $200,000

Answer: D

Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

3) Sources of funds for 2003 totaled ________. (See Figure 2.2) 3) ________

A) $700 B) $600 C) $950 D) $800

Answer: C

Explanation: A)
B)
C)
D)

4) Given the financial manager's preference for faster receipt of cash flows, 4) ________

A) a longer depreciable life is preferred to a shorter one.
B) the manager is not concerned with depreciable lives, because depreciation is a non-cash expense.
C) a shorter depreciable life is preferred to a longer one.
D) the manager is not concerned with depreciable lives, because once purchased, depreciation is considered a sunk cost.

Answer: C

Explanation: A)
B)
C)
D)

5) Capital budgeting is 5) ________

A) necessary whenever an executive wants to determine how to report earnings on the financial statements.

B) not related to finance, but rather a marketing term.

C) the methods used to determine a firm's hurdle rate for new projects.

D) the methods used to value a real project.

Answer: D

Explanation: A)

B)

C)

D)

6) The ________ summarizes the firm's funds flow over a given period of time. 6) ________

A) statement of cash flows

B) income statement

C) statement of retained earnings

D) balance sheet

Answer: A

Explanation: A)

B)

C)

D)

7) A corporation had an operating loss in 2002. All prior years had positive earnings. In utilizing the tax laws on carrybacks and carryforwards on operating losses a corporation 7) ________

A) must carryback the operating loss for at least one year before it can carryforward.

B) must first carryback the loss to 1999, then to 2000 and 2001.

C) has the option of selecting whether to carryforward or carryback the loss.

D) must first carryback the loss to 2001, then to 2000 and 1999.

Answer: B

Explanation: A)

B)

C)

D)

8) The stockholder's report may include all of the following EXCEPT 8) ________

A) a cash budget.

B) a statement of retained earnings.

C) a statement of cash flows.

D) an income statement.

Answer: A

Explanation: A)

B)

C)

D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

9) The primary source of funds for the firm in 2003 is (See Figure 2.2) 9) _______

A) net income after taxes.
B) an increase in long-term debt.
C) an increase in inventory.
D) an increase in notes payable.

Answer: B
Explanation: A)
B)
C)
D)

10) The capital cost allowance (CCA) system is the depreciation method used for _______ purposes. 10) _______

A) financial reporting
B) tax
C) managerial
D) cost accounting

Answer: B
Explanation: A)
B)
C)
D)

11) For the year ended December 31, 2003, a corporation had cash flow from operating activities of -$10,000, cash flow from investment activities of $4,000, and cash flow from financing activities of $9,000. The Statement of Cash Flows would show a 11) ______

A) net decrease of $5,000 in cash and marketable securities.
B) net increase of $3,000 in cash and marketable securities.
C) net increase of $5,000 in cash and marketable securities.
D) net decrease of $3,000 in cash and marketable securities.

Answer: B
Explanation: A)
B)
C)
D)

12) Under CCA, an asset which originally cost $100,000 is being depreciated using a 4% CCA rate. The depreciation expense in year 1 is ________. 12) ______

A) $2,000 B) $6,000 C) $0 D) $4,000

Answer: A
Explanation: A)
B)
C)
D)

13) All of the following are financing cash flows EXCEPT 13) ______

A) sale of stock.
B) increasing debt.
C) repurchasing stock.
D) payment of stock dividends.

Answer: D
Explanation: A)
B)
C)
D)

14) A corporation raises $500,000 in long-term debt to acquire additional plant capacity. This is considered 14) ______

A) a financing cash flow and operating cash flow, respectively.
B) an investment cash flow.
C) a financing cash flow and investment cash flow, respectively.
D) a financing cash flow.

Answer: C
Explanation: A)
B)
C)
D)

15) A corporation sold a fixed asset for $100,000, which was also its book value. This is 15) _______
A) an operating cash flow and a use of funds.
B) an investment cash flow and a use of funds.
C) an operating cash flow and a source of funds.
D) an investment cash flow and a source of funds.

Answer: D
Explanation: A)
B)
C)
D)

16) The average tax rate of a corporation with ordinary income of $105,000 and a tax liability of $24,200 is 16) _______
A) 23 percent. B) 46 percent. C) 34 percent. D) 15 percent.

Answer: A
Explanation: A)
B)
C)
D)

17) Financial cash flows through the firm include 17) _______
A) interest expense. B) salaries.
C) rent. D) labor expense.

Answer: A
Explanation: A)
B)
C)
D)

18) Operating profits are defined as 18) _______
A) earnings after taxes. B) earnings before interest and taxes.
C) earnings before depreciation and taxes. D) sales revenue minus cost of goods sold.

Answer: B
Explanation: A)
B)
C)
D)

19) Capital losses can be 19) _______
A) cannot be written off at all. B) written off against all sources of income.
C) written off against only capital gains. D) written off against only ordinary income.

Answer: C
Explanation: A)
B)
C)
D)

20) A firm has just ended the calendar year making a sale in the amount of $200,000 of merchandise purchased during the year at a total cost of $150,500. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. One possible problem this firm may face is 20) ______

A) inability to receive credit.
B) high leverage.
C) low profitability.
D) insolvency.

Answer: D
Explanation: A)
B)
C)
D)

21) A firm has the following accounts and financial data for 2003: 21) ______

Sales revenue	$ 3,060	Cost of goods sold	$1,800
Accounts receivable	500	Preferred stock dividends	18
Interest expense	126	Tax rate	40%
Operating expenses	600	Number of shares of common	
Accounts payable	240	stocks outstanding	1,000

The firm's earnings available to common shareholders for 2003 are ________.

A) $516
B) $195
C) $302
D) -$224

Answer: C
Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

22) The smallest use of funds for the firm in 2003 is (See Figure 2.2) 22) ______

A) a decrease in long-term debts.
B) dividends.
C) an increase in inventory.
D) a decrease in notes payable.

Answer: B

Explanation: A)
B)
C)
D)

23) The cost of capital 23) ______

A) provides a hurdle for management in making capital budgeting decisions.
B) depends on the type of assets being invested in.
C) measures the riskiness of a project or firm.
D) all of the above

Answer: D

Explanation: A)
B)
C)
D)

24) Cash flows directly related to production and sale of the firm's products and services are called 24) ______

A) financing flows.
B) operating flows.
C) investment flows.
D) none of the above.

Answer: B

Explanation: A)
B)
C)
D)

25) Jennings, Inc. has a tax liability of $170,000 on pretax income of $500,000. What is the average tax rate for Jennings, Inc.? 25) ______

A) 34 percent
B) 40 percent
C) 25 percent
D) 46 percent

Answer: A

Explanation: A)
B)
C)
D)

26) The statement of retained earnings reports all of the following EXCEPT 26) ______

A) common stock dividends.
B) interest.
C) net profits after taxes.
D) preferred stock dividends.

Answer: B

Explanation: A)
B)
C)
D)

27) Dividends paid to a Canadian corporation by a Canadian corporation are 27) ______

A) exempt from tax.
B) grossed up by 25% before calculating taxes and the dividend tax credit.
C) taxed at 50% of the marginal tax rate.
D) taxed as ordinary income.

Answer: A

Explanation: A)
B)
C)
D)

28) All of the following are examples of current liabilities EXCEPT 28) ______

A) notes payable.
B) accounts payable.
C) accounts receivable.
D) accruals.

Answer: C

Explanation: A)
B)
C)
D)

29) When preparing a statement of cash flows, retained earnings adjustments are required so that which of the following are separated on the statement? 29) ______

A) revenue and cost
B) assets and liabilities
C) net income and dividends
D) amortization and purchases

Answer: C
Explanation: A)
B)
C)
D)

30) The statement of cash flows includes all of the following categories EXCEPT 30) ______

A) investment flows.
B) operating flows.
C) financing flows.
D) equity flows.

Answer: D
Explanation: A)
B)
C)
D)

31) The depreciable value of an asset, under CCA, is 31) ______

A) the full cost including installation costs.
B) the full cost including installation costs adjusted for the salvage value.
C) the full cost minus salvage value.
D) the full cost excluding installation costs.

Answer: A
Explanation: A)
B)
C)
D)

32) On the balance sheet net fixed assets represent 32) ______

A) gross fixed assets at market value minus depreciation expense.
B) gross fixed assets at cost minus depreciation expense.
C) gross fixed assets at cost minus accumulated depreciation.
D) gross fixed assets at market value minus accumulated deprecation.

Answer: C
Explanation: A)
B)
C)
D)

33) The ________ provides a financial summary of the firm's operating results during a specified period. 33) ______

A) statement of cash flows
B) income statement
C) statement of retained earnings
D) balance sheet

Answer: B
Explanation: A)
B)
C)
D)

34) The ________ represents a summary statement of the firm's financial position at a given point in time. 34) ______

A) statement of retained earnings
B) income statement
C) balance sheet
D) statement of cash flows

Answer: C

Explanation:
A)
B)
C)
D)

35) Net income after taxes are defined as 35) ______

A) EBIT minus interest and taxes.
B) sales revenue minus cost of goods sold.
C) gross profits minus operating expenses.
D) EBIT minus interest.

Answer: A

Explanation:
A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

36) The firm's cash flow from operations is ________. (See Figure 2.2) 36) ______

A) $950 B) $350 C) $150 D) $300

Answer: B

Explanation: A)
B)
C)
D)

37) Cash flows associated with purchase and sale of both fixed assets and business interests are called 37) ______

A) investment flows.
B) operating flows.
C) financing flows.
D) none of the above.

Answer: A

Explanation: A)
B)
C)
D)

38) Corporation X needs $1,000,000 and can raise this through debt at an annual rate of 10 percent, or preferred stock at an annual cost of 7 percent. If the corporation has a 40 percent tax rate, the after-tax cost of each is 38) _______

A) debt: $100,000; preferred stock: $70,000.
B) debt: $60,000; preferred stock: $70,000.
C) debt: $60,000; preferred stock: $42,000.
D) debt: $100,000; preferred stock: $42,000.

Answer: B
Explanation: A)
B)
C)
D)

39) A firm has just ended the calendar year making a sale in the amount of $150,000 of merchandise purchased during the year at a total cost of $112,500. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The net profit and cash flow for the year are 39) _______

A) $150,000 and $112,500 respectively.
B) $0 and $150,000 respectively.
C) $37,500 and -$150,000 respectively.
D) $37,500 and -$112,500 respectively.

Answer: D
Explanation: A)
B)
C)
D)

40) The statement of cash flows provides a summary of the firm's 40) _______

A) investment cash flows.
B) cash flows from operations.
C) cash inflows from financing.
D) all of the above

Answer: D
Explanation: A)
B)
C)
D)

41) Candy Corporation has pretax profits of $1.2 million, an average tax rate of 34 percent, and it pays preferred dividends of $50,000. There are 100,000 shares outstanding and no interest expenses. What is Candy Corporation's earnings per share? 41) _______

A) $7.59
B) $3.91
C) $4.52
D) $7.42

Answer: D
Explanation: A)
B)
C)
D)

42) The statement of cash flows may also be called the 42) _______

A) funds statement.
B) statement of retained earnings.
C) bank statement.
D) sources and uses statement.

Answer: D
Explanation: A)
B)
C)
D)

43) Earnings available to common shareholders are defined as net income 43) ______
A) before taxes. B) after taxes minus common dividends.
C) after taxes. D) after taxes minus preferred dividends.

Answer: D
Explanation: A)
B)
C)
D)

44) Allocation of the historic costs of fixed assets against the annual revenue they generate is called 44) ______
A) gross profits. B) amortization.
C) net profits. D) variable costing.

Answer: B
Explanation: A)
B)
C)
D)

45) Under CCA, an asset which originally cost $10,000 is being depreciated using a 20% CCA rate. What is the depreciation expense in year 2? 45) ______
A) $1,500 B) $2,100 C) $1,200 D) $1,800

Answer: D
Explanation: A)
B)
C)
D)

46) One of the most influential documents issued by a publicly held corporation is the 46) ______
A) cash flow statement. B) letter to stockholders.
C) income statement. D) annual report.

Answer: D
Explanation: A)
B)
C)
D)

47) Inputs to the statement of cash flows from the income statement include all of the following EXCEPT 47) ______
A) net income after tax. B) operating profit.
C) cash dividends. D) non-cash charges, such as amortization.

Answer: B
Explanation: A)
B)
C)
D)

48) Which of the following is a noncash expense added back to net income in determining cash flow from operating activities? 48) ______

A) selling B) administration C) amortization D) interest

Answer: C

Explanation: A)
B)
C)
D)

49) A corporation has year end 2001 and 2002 retained earnings balances of $320,000 and $400,000, respectively. The firm reported net income after taxes of $100,000 in 2002. The firm paid dividends in 2002 of ________. 49) ______

A) $100,000 B) $80,000 C) $20,000 D) $0

Answer: C

Explanation: A)
B)
C)
D)

50) The stockholder's annual report must include 50) ______

A) an income statement. B) a statement of cash flows.
C) a balance sheet. D) all of the above.

Answer: D

Explanation: A)
B)
C)
D)

51) Since financial decisions usually involve new cash flows or changes in existing ones, the relevant tax rate is the 51) ______

A) going-concern tax rate. B) marginal tax rate.
C) CCA tax rate. D) average tax rate.

Answer: B

Explanation: A)
B)
C)
D)

52) Retained earnings on the balance sheet represents 52) ______

A) cash.
B) the cumulative total of earnings reinvested in the firm.
C) net profits after taxes minus preferred dividends.
D) net profits after taxes.

Answer: B

Explanation: A)
B)
C)
D)

FIGURE 2.1

A corporation had the following earnings and loss record for the years 1997 through 2002:

1997	$200,000
1998	100,000
1999	100,000
2000	(800,000)
2001	200,000
2002	300,000

53) The corporation in Figure 2.1 had taxable income in 2001 of 53) ______

A) $200,000 B) $0 C) $160,000 D) -$200,000

Answer: B

Explanation: A)
B)
C)
D)

54) For the year ended December 31, 2003, a corporation had cash flow from operating activities of $20,000, cash flow from investment activities of -$15,000, and cash flow from financing activities of -$10,000. The Statement of Cash Flows would show a 54) ______

A) net decrease of $5,000 in cash and marketable securities.
B) net increase of $5,000 in cash and marketable securities.
C) net increase of $25,000 in cash and marketable securities.
D) net decrease of $15,000 in cash and marketable securities.

Answer: A

Explanation: A)
B)
C)
D)

55) Under CCA, an asset which originally cost $100,000, incurred installation costs of $10,000, and has an estimated salvage value of $25,000, is being depreciated using a 30% CCA rate. What is the depreciation expense in year 1? 55) ______

A) $15,000 B) $16,500 C) $12,750 D) $11,250

Answer: B

Explanation: A)
B)
C)
D)

56) For the year ended December 31, 2003, a corporation had cash flow from operating activities of $12,000, cash flow from investment activities of -$10,000, and cash flow from financing activities of $4,000. The Statement of Cash Flows would show a 56) ______

A) net increase of $6,000 in cash and marketable securities.
B) net decrease of $6,000 in cash and marketable securities.
C) net decrease of $18,000 in cash and marketable securities.
D) net increase of $2,000 in cash and marketable securities.

Answer: A
Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

57) Use of funds for 2003 totaled ________. (See Figure 2.2) 57) ______

A) $600 B) $800 C) $700 D) $950

Answer: D
Explanation: A)
B)
C)
D)

58) All of the following are true EXCEPT 58) ______

A) Capital gains is taxed as ordinary income.
B) Interest income received by a corporation is taxed as ordinary income.
C) Corporations pay taxes on all dividends received from other corporations, regardless of their share of ownership.
D) Corporations may pay taxes on only 30 percent of the dividends received from other corporations, depending on their percentage of ownership.

Answer: C

Explanation: A)
B)
C)
D)

59) The portion of the annual report where management provides analysis and explains the financial results is the 59) ______

A) management's discussion and analysis.
B) auditors note to shareholders.
C) letter to shareholders.
D) all of the above

Answer: A

Explanation: A)
B)
C)
D)

60) When preparing a statement of cash flows, retained earnings adjustments are required so that which of the following are separated on the statement? 60) ______

A) assets and liabilities
B) depreciation and purchases
C) revenue and cost
D) net profits and dividends

Answer: D

Explanation: A)
B)
C)
D)

61) Capital gains are taxed at ________ of the investor's marginal tax rate. 61) ______

A) 100 percent
B) 25 percent
C) 50 percent
D) 66.67 percent

Answer: C

Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

62) Common stock dividends paid in 2003 amounted to ________. (See Figure 2.2) 62) ______

A) $600 B) $50 C) $150 D) $100

Answer: B

Explanation: A)
B)
C)
D)

63) Corporations experiencing operating losses are allowed to 63) ______

A) carryback the losses for 5 years and carryforward for 2 years.
B) only carryforward the losses 20 years.
C) carryback the losses for 3 years and carryforward for 7 years.
D) carryback the losses for 2 years and carryforward for 2 years.

Answer: C

Explanation: A)
B)
C)
D)

64) All of the following are noncash charges EXCEPT 64) _______

A) amortization. B) accruals. C) depreciation. D) depletion.

Answer: B

Explanation: A)
B)
C)
D)

65) Parliament allows Canadian corporations to exclude from taxes 100 percent of dividends received from other Canadian corporations. Parliament did this to 65) _______

A) lower the cost of equity financing for corporations.
B) avoid triple taxation on dividends.
C) encourage corporations to invest in each other.
D) avoid double taxation on dividends.

Answer: B

Explanation: A)
B)
C)
D)

66) Operating profits are defined as 66) _______

A) earnings before depreciation and taxes.
B) gross profits minus operating expenses.
C) sales revenue minus depreciation expense.
D) sales revenue minus cost of goods sold.

Answer: B

Explanation: A)
B)
C)
D)

67) The after-tax cost of a $40 can of paint to a company with a marginal tax rate of 40% is 67) _______

A) $24. B) $40.
C) $16. D) not determinable.

Answer: A

Explanation: A)
B)
C)
D)

68) A firm has the following accounts and financial data for 2003: 68) ______

Sales revenue	$ 3,060	Cost of goods sold	$1,800
Accounts receivable	500	Preferred stock dividends	18
Interest expense	126	Tax rate	40%
Operating expenses	600	Number of shares of common	
Accounts payable	240	stocks outstanding	1,000

The firm's earnings per share, rounded to the nearest cent, for 2003 is ________.

A) $0.53 B) $0.51 C) $0.30 D) $0.32

Answer: C

Explanation: A)
B)
C)
D)

69) The tax deductibility of expenses ________ their after-tax cost. 69) ______

A) has no effect on
B) has an undetermined effect on
C) reduces
D) increases

Answer: C

Explanation: A)
B)
C)
D)

70) Cash flows that result from debt and equity financing transactions, including incurrence and repayment of debt, cash inflows from the sale of stock, and cash outflows to pay cash dividends or repurchase stock are called 70) ______

A) financing flows.
B) operating flows.
C) investment flows.
D) none of the above.

Answer: A

Explanation: A)
B)
C)
D)

71) A firm's operating cash flow is defined as 71) ______

A) gross profit minus operating expenses.
B) EBIT - taxes + depreciation.
C) EBIT + depreciation.
D) gross profit minus depreciation.

Answer: B

Explanation: A)
B)
C)
D)

72) The depreciable life of an asset is of concern to the financial manager, and 72) ______

A) a longer depreciable life is preferred, because management can postpone purchasing new assets, since the old assets still have a useful life.
B) a shorter depreciable life is preferred, because it will result in a faster receipt of cash flows.
C) a shorter depreciable life is preferred, because management can then purchase new assets, as the old assets are written off.
D) a longer depreciable life is preferred, because it will result in a faster receipt of cash flows.

Answer: B
Explanation: A)
B)
C)
D)

73) Accounting practices and procedures used to prepare financial statements are called 73) ______

A) CICA. B) GAAP. C) CCRA. D) AcSB.

Answer: B
Explanation: A)
B)
C)
D)

FIGURE 2.1

A corporation had the following earnings and loss record for the years 1997 through 2002:

1997	$200,000
1998	100,000
1999	100,000
2000	(800,000)
2001	200,000
2002	300,000

74) If the corporation in Figure 2.1 had a 40 percent tax rate for all years, they received a tax refund in 2000 in the amount of 74) ______

A) $240,000 B) $80,000 C) $480,000 D) $320,000

Answer: B
Explanation: A)
B)
C)
D)

75) The dividend exemption for Canadian corporations receiving dividends from another Canadian corporation has resulted in 75) ______

A) stock investments being relatively less attractive, relative to bond investments made by one corporation in another corporation.
B) a higher relative cost of bond-financing for the corporation paying the dividend.
C) stock investments being relatively more attractive relative to bond investments made by one corporation in another corporation.
D) a lower cost of equity for the corporation paying the dividend.

Answer: C
Explanation: A)
B)
C)
D)

76) If a corporation sells certain assets for more than their initial purchase price, the difference between the sale price and the purchase price is called 76) ______

A) an ordinary gain.
B) a capital gain.
C) an ordinary loss.
D) a capital loss.

Answer: B
Explanation: A)
B)
C)
D)

77) The rule-setting body, which authorizes generally accepted accounting principles is the 77) ______

A) Government of Canada.
B) AcSB.
C) TSX.
D) GAAP.

Answer: B
Explanation: A)
B)
C)
D)

78) In Canada, the Board of Directors are generally 78) ______

A) selected from a small group of inter-related people.
B) politicians or an appointee.
C) women.
D) Aboriginal leaders and elders.

Answer: A
Explanation: A)
B)
C)
D)

79) Gross profits are defined as 79) ______

A) operating profits minus depreciation.
B) sales revenue minus cost of goods sold.
C) operating profits minus cost of goods sold.
D) sales revenue minus operating expenses.

Answer: B

Explanation: A)
B)
C)
D)

80) Corporate taxes are paid through 80) ______

A) higher prices to the consumer.
B) lower returns to the investor.
C) lower wages to workers.
D) all of the above.

Answer: D

Explanation: A)
B)
C)
D)

81) A firm has the following accounts and financial data for 2003: 81) ______

Sales revenue	$ 3,060	Cost of goods sold	$1,800
Accounts receivable	500	Preferred stock dividends	18
Interest expense	126	Tax rate	40%
Operating expenses	600	Number of shares of common	
Accounts payable	240	stocks outstanding	1,000

The firm's net income after taxes for 2003 is ________.

A) $213
B) $206
C) -$206
D) $320

Answer: D

Explanation: A)
B)
C)
D)

82) The small business deduction for eligible Canadian-controlled private corporations is 82) ______

A) 16%.
B) 44%.
C) 7%.
D) 28%.

Answer: A

Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

83) The firm may have increased long-term debts to finance (See Figure 2.2) 83) ______

A) an increase in gross fixed assets.
B) a decrease in notes payable.
C) an increase in current assets, an increase in gross fixed assets, and a decrease in notes payable.
D) an increase in current assets.

Answer: C
Explanation: A)
B)
C)
D)

84) Capital cost allowance is 84) ______

A) calculated in the year of acquisition using the half-year rule.
B) amortized on a declining balance basis.
C) amortized using a pre-established CCA rate.
D) all of the above.

Answer: D
Explanation: A)
B)
C)
D)

85) Corporation A owns 15 percent of the stock of corporation B. Corporation B pays corporation A $100,000 in dividends in 2002. Corporation A must pay tax on 85) ______

A) $50,000. B) $100,000. C) $125,000. D) nothing.

Answer: D
Explanation: A)
B)
C)
D)

86) A corporation has a year end 2001 retained earnings balance of $220,000. The firm reported net income after taxes of $50,000 in 2002 and paid dividends in 2002 of $30,000. The firm's retained earnings balance at year end 2002 is ________. 86) ______

A) $250,000 B) $300,000 C) $270,000 D) $240,000

Answer: D
Explanation: A)
B)
C)
D)

87) Johnson, Inc. has just ended the calendar year making a sale in the amount of $10,000 of merchandise purchased during the year at a total cost of $7,000. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The net profit and cash flow for the year are 87) ______

A) $3,000 and -$7,000 respectively.
B) $3,000 and $7,000 respectively.
C) $7,000 and -$3,000 respectively.
D) $3,000 and $10,000 respectively.

Answer: A
Explanation: A)
B)
C)
D)

88) The first step in preparing a statement of cash flows is to 88) ______
A) calculate changes in balance sheet accounts.
B) adjust retained earnings.
C) calculate the amortization expense.
D) calculate changes in income statement accounts.

Answer: A
Explanation: A)
B)
C)
D)

89) All of the following are examples of fixed assets EXCEPT 89) ______
A) buildings.
B) automobiles.
C) marketable securities.
D) equipment.

Answer: C
Explanation: A)
B)
C)
D)

90) A corporation 90) ______
A) must use the same depreciation method for tax and financial reporting purposes.
B) must use different (from for tax purposes), but strictly mandated, depreciation methods for financial reporting purposes.
C) may use different depreciation methods for tax and financial reporting purposes.
D) must use different depreciation methods for tax and financial reporting purposes.

Answer: C
Explanation: A)
B)
C)
D)

91) All of the following are operating cash flows EXCEPT 91) ______
A) an increase or decrease in fixed assets.
B) an increase or decrease in current liabilities.
C) amortization expense.
D) net income after taxes.

Answer: A
Explanation: A)
B)
C)
D)

92) Under CCA, an asset which originally cost $100,000 is being depreciated using a 30% CCA rate. The depreciation expense in year 3 is ________. 92) ______
A) $21,000
B) $17,850
C) $10,440
D) $12,030

Answer: B
Explanation: A)
B)
C)
D)

93) The depreciable value of an asset, under CCA, is 93) ______

A) the original cost (purchase price) only.
B) the original cost plus installation.
C) the original cost minus salvage value.
D) the original cost plus installation costs, minus salvage value.

Answer: B
Explanation: A)
B)
C)
D)

94) The cash flows from operating activities of the firm include 94) ______

A) taxes paid.
B) labor expense.
C) dividends paid.
D) interest expense.

Answer: B
Explanation: A)
B)
C)
D)

95) Firm ABC has operating profits of $100,000, taxes of $17,000, interest expense of $34,000 and preferred dividends of $5,000. What is the firm's net income after taxes? 95) ______

A) $66,000
B) $83,000
C) $49,000
D) $44,000

Answer: C
Explanation: A)
B)
C)
D)

96) A firm has year end 2001 and 2002 retained earnings balances of $670,000 and $560,000, respectively. The firm paid $10,000 in dividends in 2002. The firm's net income after taxes in 2002 is ________. 96) ______

A) $100,000
B) $110,000
C) -$100,000
D) -$110,000

Answer: C
Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

97) The amortization expense for 2003 is ________. (See Figure 2.2) 97) ______

A) $200 B) $0 C) $1,000 D) $50

Answer: A

Explanation: A)
B)
C)
D)

98) All of the following are examples of current assets EXCEPT 98) ______

A) accounts receivable. B) inventory.
C) cash. D) accruals.

Answer: D

Explanation: A)
B)
C)
D)

FIGURE 2.2

RUFF SANDPAPER CO.
Balance Sheets
For the Years Ended 2002 and 2003

	2003	2002
Assets		
Cash	800	600
Marketable securities	200	200
Accounts receivable	1,200	1,000
Inventories	2,000	1,800
Gross fixed asset	3,000	2,800
Less Accumulated amortization	1,000	800
Net fixed assets	2,000	2,000
	------	------
Total assets	6,200	5,600
	=====	=====
Liabilities		
Accounts payable	200	100
Notes payable	800	900
Accruals	100	100
Long-term debt	2,000	1,500
Stockholders' equity		
Common stock	2,500	2,500
Retained earnings	600	500
	------	------
Total liabilities and equity	6,200	5,600
	======	======

Net profits after taxes for 2003: $150.00

99) The firm ________ fixed assets worth ________. (See Figure 2.2) 99) ______

A) sold; $200
B) sold; $0
C) purchased; $0
D) purchased; $200

Answer: D
Explanation: A)
B)
C)
D)

100) Three important inputs to the statement of cash flows must be obtained from an income statement for the period of concern. These inputs are all of the following EXCEPT 100) _____

A) amortization and any noncash charges.
B) cash dividends paid on both preferred and common stocks.
C) net income after taxes.
D) interest expenses.

Answer: B
Explanation: A)
B)
C)
D)

101) The net value of fixed assets is also called their 101) ______

A) book value. B) market value. C) price. D) par value.

Answer: A

Explanation: A)
B)
C)
D)

102) The cash flows from operating activities of the firm include 102) ______

A) stock repurchases. B) dividends paid.
C) interest expense. D) cost of raw materials.

Answer: D

Explanation: A)
B)
C)
D)

103) A capital gain occurs when an asset has been held for 103) ______

A) more than one year. B) any length of time.
C) more than six months. D) less than six months.

Answer: B

Explanation: A)
B)
C)
D)

104) Total assets less net fixed assets equals 104) ______

A) current assets. B) gross assets.
C) liabilities and equity. D) depreciation.

Answer: A

Explanation: A)
B)
C)
D)

105) Which of the following is a source of cash flows? 105) ______

A) interest expense B) taxes
C) amortization D) cost of goods sold

Answer: C

Explanation: A)
B)
C)
D)

106) All of the following are sources of cash EXCEPT 106) ______

A) an increase in accruals.
B) net profits after taxes.
C) dividends.
D) a decrease in accounts receivable.

Answer: C
Explanation: A)
B)
C)
D)

107) A firm has year end 2001 and 2002 retained earnings balances of $670,000 and $560,000, respectively. The firm reported net profits after taxes of $100,000 in 2002. The firm paid dividends in 2002 of ________. 107) ______

A) $210,000
B) $110,000
C) $100,000
D) $10,000

Answer: A
Explanation: A)
B)
C)
D)

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

108) The income statement is a financial summary of the firm's operating results during a specified period, while the balance sheet is a summary statement of the firm's financial position at a given point in time. 108) ______

Answer: True False
Explanation:

109) The Canada Customs and Revenue Agency provides businesses with a table of CCA rates used to amortize fixed assets for tax purposes. 109) ______

Answer: True False
Explanation:

110) In the statement of cash flow, the financing flows are cash flows that result from debt and equity financing transactions, including incurrence and repayment of debt, cash inflow from the sale of stock, and cash outflows to repurchase stock or pay cash dividends. 110) ______

Answer: True False
Explanation:

111) The sale of every business requires a premium be paid to cover the cost of goodwill. 111) ______

Answer: True False
Explanation:

112) Earnings per share represents the amount earned during the period on each outstanding share of common stock. 112) ______

Answer: True False
Explanation:

113) The more risky an investment, the greater the investor's expected return and the greater the probability of less than desireable results. 113) ______

Answer: True False
Explanation:

114) An increase in the firm's cash balance is a source of cash flow. 114) ______

Answer: True ✓ False

Explanation:

115) In the statement of cash flow, the operating cash flows are cash flows directly related to purchase and sale of fixed assets. 115) ______

Answer: True ✓ False

Explanation:

116) The net fixed asset investment is defined as the change in net fixed assets plus amortization expense for the period. 116) ______

Answer: ✓ True False

Explanation:

117) Amortization is the systematic expensing of a portion of the cost of a fixed asset against sales. 117) ______

Answer: ✓ True False

Explanation:

118) The CCA depreciation method requires use of the half-year convention. Assets are assumed to be acquired in the middle of the year and only one-half of the first year's depreciation is recovered in the first year. 118) ______

Answer: ✓ True False

Explanation:

119) The ordinary income of a corporation is income earned through the sale of a firm's goods and services and is currently taxed subject to the individual income tax rates. 119) ______

Answer: True ✓ False

Explanation:

120) The CICA has developed a set of accounting standards that specify the four financial statements that companies must develop and how information is to be presented and disclosed in the financial statements. 120) ______

Answer: ✓ True False

Explanation:

121) The Canadian Institute of Chartered Accountants, part of the Accounting Standards Board, is the accounting profession's rule-setting body that authorizes accounting practices and principles. 121) ______

Answer: True ✓ False

Explanation:

122) A statement of cash flows reconciles the net income earned during a given year, and any cash dividends paid, with the change in retained earnings between the start and end of that year. 122) ______

Answer: True ✓ False

Explanation:

123) A benefit of holding cash is the liquidity it gives the firm. 123) ______

Answer: ✓ True False

Explanation:

124) The manufacturing and processing deduction allows manufacturing and processing businesses a 7 percent reduction from the effective general federal tax rate in 2001. 124) ______

Answer: ✓ True False
Explanation:

125) The president's letter, as the first component of the stockholders' report, is the primary communication from management to the firm's employees. 125) ______

Answer: True ✓ False
Explanation:

126) The marginal tax rate represents the rate at which additional income is taxed. 126) ______

Answer: ✓ True False
Explanation:

127) Net fixed assets represent the difference between gross fixed assets and the total expense recorded for the depreciation of fixed assets. 127) ______

Answer: ✓ True False
Explanation:

128) Earnings per share results from dividing earnings available for common stockholders by the number of shares of common stock authorized. 128) ______

Answer: True ✓ False
Explanation:

129) GAAP is the accounting profession's rule-setting body. 129) ______

Answer: True ✓ False
Explanation:

130) Publicly owned corporations are those which are financed by proceeds from government treasury securities. 130) ______

Answer: True ✓ False
Explanation:

131) A Canadian-controlled private corporation's first $500,000 of taxable income qualifies for the small business deduction. 131) ______

Answer: True ✓ False
Explanation:

132) Business firms are permitted to systematically charge a portion of the market value of fixed assets, as depreciation, against annual revenues. 132) ______

Answer: True ✓ False
Explanation:

133) An increase in the accounts payable account results in a outflow of cash. 133) ______

Answer: True ✓ False
Explanation:

134) An increase in a firm's inventory account results in an outflow of cash. 134) ______

Answer: ✓ True False
Explanation:

135) In finance, operating cash flow is the cash flow a firm generates from its normal operations, calculated as EBIT - taxes + depreciation. 135) ______

Answer: ✓ True False
Explanation:

136) Under the capital cost allowance (CCA) procedures, the depreciable value of a fixed asset is its full cost, including outlays for installation. 136) ______

Answer: ✓ True False
Explanation:

137) The statement of cash flows allows the financial manager and other interested parties to analyze the firm's past and possibly future profitability. 137) ______

Answer: True ✓ False
Explanation:

138) Common stock consists of two components, contributed capital and retained earnings. 138) ______

Answer: ✓ True False
Explanation:

139) A long-term government of Canada bond is considered a marketable security. 139) ______

Answer: True ✓ False
Explanation:

140) Noncash charges are expenses that involve an actual outlay of cash during the period but are not deducted on the income statement. 140) ______

Answer: True ✓ False
Explanation:

141) The depreciable life of an asset can significantly affect the pattern of cash flows. The shorter the depreciable life of an asset, the more quickly the cash flow created by the depreciation write-off will be received. 141) ______

Answer: ✓ True False
Explanation:

142) A share of stock was purchased for $2 and sold 3 years later for $5. The $5 increase in value is taxed as a capital gain. 142) ______

Answer: True ✓ False
Explanation:

143) Generally Accepted Accounting Principles are authorized by the Canadian Institute of Chartered Accountants. 143) ______

Answer: ✓ True False
Explanation:

144) Given the financial manager's preference for faster receipt of cash flows, a longer depreciable life is preferred to a shorter one. 144) ______

Answer: True ✓ False
Explanation:

145) The par value of common stock is an arbitrarily assigned per share value used primarily for accounting purposes. 145) ______

Answer: True False
Explanation:

146) The net working capital investment is defined as the change in current assets minus the change in current liabilities. 146) ______

Answer: True False
Explanation:

147) Capital cost allowance is simply the tax version of amortization. 147) ______

Answer: True False
Explanation:

148) Publicly owned corporations are required by the provincial securities commissions and stock exchanges to provide their stockholders with an annual stockholders' report. 148) ______

Answer: True False
Explanation:

149) An investor receives a $500 dividend cheque from Bell Canada; this is considered passive income. 149) ______

Answer: True False
Explanation:

150) Amortization is considered to be use of cash flow since the cash must be drawn from somewhere. 150) ______

Answer: True False
Explanation:

151) The balance sheet is a statement which balances the firm's assets (what it owns) against its debt (what it owes). 151) ______

Answer: True False
Explanation:

152) Retained earnings represents the cumulative total of all earnings retained and reinvested in the firm since its inception. 152) ______

Answer: True False
Explanation:

153) Canadian- controlled private corporations have tax advantages relative to public companies. 153) ______

Answer: True False
Explanation:

154) The finance definition of operating cash flow excludes interest as an operating flow, whereas the accounting definition includes it as an operating flow. 154) ______

Answer: True False
Explanation:

155) Both present and prospective shareholders are interested in the firm's current and future level of risk and return. These two dimensions directly affect share price. 155) ______

Answer: True False
Explanation:

156) The statement of cash flows provides insight into the firm's assets and liabilities and reconciles them with changes in its cash and marketable securities during the period of concern. 156) ______

Answer: True ✓ False
Explanation:

157) To assess whether any developments have occurred that are contrary to the company's financial policies, the financial manager should pay special attention to both the major categories of cash flow and the individual items of cash inflow and outflow. 157) ______

Answer: ✓ True False
Explanation:

158) Common stock dividends paid to stockholders are equal to the earnings available for common stockholders divided by the number of shares of common stock outstanding. 158) ______

Answer: True ✓ False
Explanation:

159) Dividends paid to shareholders requires an outflow of cash. 159) ______

Answer: ✓ True False
Explanation:

160) The original price per share received by the firm on a single issue of common stock is equal to the the contributed capital divided by the number of shares outstanding. 160) ______

Answer: ✓ True False
Explanation:

161) Because amortization is treated as a separate source of cash, only net rather than gross changes in fixed assets appear on the statement of cash flows. 161) ______

Answer: True ✓ False
Explanation:

162) Cash flow from operations is equal to the firm's net income after taxes minus all noncash charges. 162) ______

Answer: True ✓ False
Explanation:

163) The stated (par) value on preferred stock represents the actual price for which the shares must be sold. 163) ______

Answer: True ✓ False
Explanation:

164) Unlike the United States, in Canada public corporations have no obligation to report their financial results through an annual report to shareholders. 164) ______

Answer: True ✓ False
Explanation:

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

165) Jimmy Construction Limited at the start of 2003 had no assets in the Class 10 asset pool. During the year, Jimmy Construction purchased two trucks and a trailer for $120,000. Set-up a capital cost allowance (CCA) schedule and calculate the CCA for the years 2003 to 2007.

If at the end of 2007 Jimmy Construction sold all the assets in the Class 10 asset pool for $40,000, would the company have a terminal loss or a recapture? Calculate the dollar amount of the terminal loss or recapture.

Answer:

Year	Opening UCC	Net Additions	CCA	Ending UCC
2003		$120,000	$18,000	$102,000
2004	$102,000		30,600	71,400
2005	71,400		21,420	49,980
2006	49,980		14,994	34,986
2007	34,986		10,496	24,490

Recapture = (40,000 - 24,490) = $15,510

166) Ag Silver Mining, Inc. has $500,000 of earnings before interest and taxes at the year end. Interest expenses for the year were $10,000. The firm expects to distribute $100,000 in dividends. Calculate the earnings after taxes for the firm assuming a 40 percent tax on ordinary income.

Answer:

Earnings before interest and taxes	$500,000
Less: Interest	10,000

Earnings before taxes	$490,000
Less: Taxes (40%)	196,000

Earnings after taxes	$294,000

167) Reliable Auto Parts has 5000 shares of common stock outstanding. The company also has the following amounts in revenue and expense accounts:

Sales revenue	$ 85,000
General and administrative expense	7,500
Interest expense	3,500
Depreciation expense	5,000
Preferred stock dividends	500
Selling expense	4,000
Cost of goods sold	50,000

Calculate:

a. gross profits
b. operating profits
c. net income before taxes
d. net income after taxes (assume a 40 percent tax rate)
e. cash flow from operations
f. earnings available to common stockholders
g. earnings per share

Answer: a.

Sales revenue	$85,000
- cost of goods sold	- 50,000
-------------------	--------
gross profits	$35,000

b.

Gross profits		$35,000
- operating expenses		
selling expense	4,000	
general & adm. expense	7,500	
depreciation expense	5,000	
---------------------	--------	
		$16,500

Operating profits		$18,500

c.

Operating profits	$18,500
- interest expense	- 3,500
---------------------	--------
net profits before taxes	$15,000

d.

net profits before taxes	$15,000
- taxes (40%)	- 6,000
---------------------	--------
net profits after taxes	$ 9,000

e.

net profits after taxes	$ 9,000
+ depreciation expense	+ 5,000
----------------------	--------
cash flow from operations	$14,000

f.

net profits after taxes	$ 9,000
- preferred dividends	- 500
----------------------	--------
earnings available for C.S.	$ 8,500

g.

$$\frac{\text{earnings available for C.S.}}{\text{\# of common shares outstanding}} = \frac{\$8{,}500}{5{,}000} = \$1.70/\text{share}$$

168) On December 31, 2001, the Bradshaw Corporation had $485,000 as an ending balance for its retained earnings account. During 2002, the corporation declared a $3.50/share dividend to its stockholders. The Bradshaw Corporation has 35,000 shares of common stock outstanding. When the books were closed for 2002 year end, the corporation had a final retained earnings balance of $565,000. What was the net income earned by Bradshaw Corporation during 2002?

Answer: Dividends = ($3.50/share) (35,000 shares) = $122,500

Retained Earnings (2001)	$485,000
Net Income After Taxes (2002)	X
Dividends	122,500
------------------------	--------
Retained Earnings (2002)	$565,000

Net Profits After Taxes = $202,500

169) During 2002, a firm has sold 5 assets at book value. Calculate the tax liability on the assets. The firm pays a 40 percent tax rate on ordinary income.

Asset	Purchase Price	Sale Price
1	$10,000	$12,000
2	$50,000	$40,000
3	$37,500	$50,000
4	$ 3,000	$ 3,500
5	$15,000	$12,000

Answer:

Asset		Tax Liability
1	$2,000(.40)(0.5)	= $400
2	---	
3	$12,500(.40)(0.5)	= $2,500
4	$500(.40)(0.5)	= $100
5	---	

170) The values shown on the balance sheet for the firm's assets are book values and generally are not what the assets are worth in the open market. State two reasons why this is the case?

Answer: 1) The historical cost principle is objective and conservative, but does not reflect market realities.
2) Items like goodwill, human capital, competitive advantages, and growth options are not accounted for in the financial statements.

171) The Sunshine Company had a retained earnings balance of $850,000 at the beginning of 2002. By the end of 2002, the company's retained earnings balance was $950,000. During 2002, the company earned $245,000 as net income after taxes. The company was then able to pay its preferred stockholders $45,000. Compute the common stock dividend per share in 2002 assuming 10,000 shares of common stock outstanding.

Answer:

Retained Earnings (2001)	$850,000
Net Profits After Taxes (2002)	245,000
Preferred Stock Dividend	(45,000)
Common Stock Dividend	X
------------------------	--------
Retained Earnings (2002)	$950,000

Total common stock dividend = $100,000
Common stock dividend per share = 100,000/10,000 = $10

172) A corporation has the following record of earnings for the years 1996 through 2002.

a. Indicate the carryback/carryforward amounts.
b. Calculate the tax refund in 2001 if their tax rate during this time period has been 40 percent.
c. Indicate the carryforward, the taxable earnings, and tax liability for 2002.

Year	Taxable earnings
1996	$ 400,000
1997	500,000
1998	600,000
1999	400,000
2000	300,000
2001	-1,500,000
2002	500,000

Answer: a.

Year	Taxable Earnings	CB/CF	Cumulative Earnings	Adjusted
1996	$ 400,000	$	$	$
1997	500,000			
1998	600,000	600,000	600,000	
1999	400,000	400,000	1,000,000	0
2000	300,000	300,000	1,300,000	0
2001	-1,500,000			
2002	500,000	200,000	1,500,000	0

b. Tax refund in 2001:
($1,300,00)(0.40) = $520,000

c. Carryforward to 2002: = $200,000
Taxable earnings: $500,000 - $200,000 = $300,000
Tax liability: ($300,000)(0.40) = $120,000

173) Given the financial data for New Electronic World, Inc. (NEW), compute the following measures of cash flows for the NEW for the year ended December 31, 2003.

A. Operating Cash Flow.

B. Free Cash Flow.

	For the year ended December 31,	
	2002	2003
Depreciation		$3,000
EBIT		30,000
Interest expenses		3,000
Taxes		8,000
Cash	$21,000	24,000
Accounts Receivable	39,000	45,000
Inventory	27,000	30,000
Net fixed assets	22,000	24,000
Accounts payable	25,000	30,000
Notes payable	50,000	40,000
Accruals	1,000	2,000

Answer: a. OCF = EBIT - Taxes + Depreciation

OCF = $30,000 - $8,000 + $3,000 = $35,000

b. FCF = OCF - Net fixed asset investment (NFAI) - Net current asset investment (NCAI)

NFAI = Change in net fixed assets + Depreciation
= (24,000 - 22,000) + 3,000 = $5,000

NCAI = Change in current assets - change in (Accounts payable + Accruals)
= (99,000 - 87,000) - (32,000 - 26,000)
= $6,000

FCF = 35,000 - 5,000 - 6,000 = $24,000

174) Identify each expense or revenue as a cash flow from operating activities (O), a cash flow from investment activities (I), or a cash flow from financing activities (F).

Administrative expenses
Rent payment
Interest on a note payable
Interest on a note receivable
Sale of equipment
Dividend payment
Stock repurchase
Sale of finished goods
Labor expense
Sale of a bond issue
Repayment of a long-term debt
Selling expenses
Amortization expense
Sale of common stock
Purchase of fixed assets

Answer:

Administrative expenses........................	O
Rent payment...	O
Interest on a note payable......................	F
Interest on a note receivable..................	F
Sale of equipment...................................	I
Dividend payment.................................	F
Stock repurchase.....................................	F
Sale of finished goods.............................	O
Labor expense..	O
Sale of a bond issue................................	F
Repayment of a long-term debt............	F
Selling expenses......................................	O
Depreciation expense..............................	O
Sale of common stock.............................	F
Purchase of fixed assets..........................	I

175) Given the Income Statement, Statement of Changes in Retained Earnings and Balance Sheet, prepare a Statement of Cash Flows.

ABC confectionery Limited
Income Statement
For the year ended December 31, 2003

Sales Revenue	$1,000,000
less: Cost of Goods Sold	575,000

Gross Profit	$425,000
Expenses:	
Operating Expenses	$225,000
Marketing Expenses	25,000
Administrative Expenses	25,000

Total Expenses	275,000

EBIT	$150,000
Interest Expense	15,000

EBT	$135,000
Taxes	27,000

Net Income after taxes	$108,000

Note: Amortization Expense = $10,400

ABC confectionery Limited
Statement of Changes in Retained Earnings
For the year ended December 31, 2003

Retained Earnings, January 1, 2003	$ 20,000
Add: Net Income	108,000

Total	$128,000
less: Dividends Declared and Paid	120,000

Retained Earnings, December 31, 2003	$ 8,000

ABC confectionery Limited
Balance Sheet
December 31, 2003

Assets	2003	2002
Current Assets:		
Cash	$ 36,900	$ 16,000
Accounts Receivable	6,000	4,000
Inventory	44,000	50,000
Prepaid Expenses	2,000	2,000
	-------	-------
Total Current Assets	$ 88,900	$ 72,000
Fixed Assets:		
Fixtures and Equipment	$ 90,000	$ 80,000
less: Accumulated Amortization	(68,000)	(60,000)
Building	120,000	120,000
less: Accumulated Amortization	(62,400)	(60,000)
Net Building	57,600	60,000
	-------	-------
Total Fixed Assets	$ 79,600	$ 80,000
	-------	-------
Total Assets	$168,500	$152,000
Liabilities		
Current Liabilities:		
Accounts Payable	$ 22,500	$ 15,000
Interest Payable	3,000	4,000
Taxes Payable	40,000	8,000
	-------	-------
Total Current Liabilities	$ 65,500	$ 27,000

Long-term Liabilities:

Business Loan	$ 25,000	$ 35,000
Mortgage on Building	57,500	60,000
	-------	--------
Total Long-term Liabilities	$ 82,500	$ 95,000
	-------	--------
Total Liabilities	$148,000	$122,000
Shareholders' Equity:		
Common Shares	$ 12,500	$ 10,000
Retained Earnings	8,000	20,000
	-------	-------
Total Shareholders' Equity	$ 20,500	$ 30,000
	-------	-------
Total Liab. and Shareholder's Equity	$168,500	$152,000

Answer: ABC confectionery Limited
Statement of Changes in Financial Position
For the year ended December 31, 2003

Operating Activities:	
Net Income	$108,000
Add:	
Inventory (decrease)	6,000
Accounts Payable (increase)	7,500
Taxes Payable (increase)	32,000
Depreciation Expense	10,400
Deduct:	
Accounts Receivable (increase)	(2,000)
Interest Payable (decrease)	(1,000)

Net Cash Flow from Operating Activities	$160,900
Investing Activities:	
Net purchases of Fixtures and Equipment	$(10,000)

Net Cash Flow from Investing Activities	$(10,000)
Financing Activities:	
Principal paid on Business Loan	$(10,000)
Principal paid on Mortgage	(2,500)
Dividends paid to shareholders	(120,000)
Issuance of shares	2,500

Net Cash Flow from Financing Activities	$(130,000)

Net Increase in Cash	$ 20,900

176) Calculate the change in the key balance sheet accounts between 2002 and 2003 and classify each as a source(S), a use(U), or neither(N), and indicate which type of cash flow it is: an operating cash flow (O), and investment cash flow (I) or a financing cash flow (F).

ABC Corp.
Balance Sheet Changes and Classification
of Key Accounts between 2002 and 2003

Account	2003	2002	Change	Classification	Type
Long-term debts	$ 960	$ 800			
Accounts receivable	640	500			
Common stock	200	200			
Cash	640	500			
Retained earnings	960	800			
Accruals	50	200			
Inventory	840	600			
Accounts payable	1,150	1,000			
Net fixed assets	1,800	2,000			

Answer:

ABC Corp.
Balance Sheet Changes and Classification
of Key Accounts between 2002 and 2003

Account	2003	2002	Chng	Classif.	Type
Long-term debts	$ 960	$ 800	+160	S	F
Accounts receivable	640	500	+140	U	O
Common stock	200	200	0	N	F
Cash	640	500	+140	U	O
Retained earnings	960	800	+160	S	O/F
Accruals	50	200	-150	U	O
Inventory	840	600	+240	U	O
Accounts payable	1,150	1,000	+150	S	O
Net fixed assets	1,800	2,000	-200	S	I

177) Darling Paper Container, Inc. purchased several machines at a total cost of $275,000. The installation cost for this equipment was $25,000. The firm plans to depreciate the equipment using a 20% CCA rate. Prepare a depreciation schedule showing the depreciation expense for each of the first five years.

Answer:

Depreciation Schedule

Year	Depreciation Expense	
1	$300,000	× .10 = 30,000
2	$270,000	× .20 = 54,000
3	$216,000	× .20 = 43,200
4	$172,800	× .20 = 34,560
5	$138,240	× .20 = 27,648

178) Colonial Furniture's net profits before taxes for 2002 totaled $354,000. The company's total retained earnings were $338,000 for 2001 year end and $389,000 for 2002 year end. Colonial is subject to a 26% tax rate. How large was the cash dividend declared by Colonial Furniture in 2002?

Answer:

Net Profits Before Taxes	$354,000
Less: Taxes (26%)	92,040

Net Profits After Taxes	$261,960
Retained Earnings (2001)	$338,000
Net Profits After Taxes (2002)	261,960
Dividends	X
-----------------------	--------
Retained Earnings (2002)	$389,000

Dividends = $210,960

179) At the end of 2002, the Long Life Light Bulb Company announced it had produced a gross profit of $1 million. The company has also established that over the course of this year it has incurred $345,000 in operating expenses and $125,000 in interest expenses. The company is subject to a 30% tax rate and has declared $57,000 total preferred stock dividends.

a. How much is the earnings available for common stockholders?

b. Compute the increased retained earnings for 2002 if the company were to declare a $4.25 common stock dividend. The company has 125,000 shares of common stock outstanding.

Answer: a.

Gross Profits	$1,000,000
Less: Operating expenses	(345,000)

Operating Profits	$ 655,000
Less: Interest	(125,000)

Net Profits before taxes	$ 530,000
Less: Taxes (30%)	(159,000)

Net Profits After Taxes	$ 371,000
Less: Preferred Stock Dividend	(57,000)

Earnings Available for Common Stock	$ 314,000

b.

Earnings Available for Common Stock	$ 314,000
Dividend = (4.25)(15,000 shares)	(63,750)

Increased Retained Earnings	$ 250,250

FIGURE 2.3

Magna Fax, Inc.
Income Statement
For the Year Ended December 31, 2003

Sales revenue	$150,000
Cost of goods sold	$117,500

Gross Profits	32,500
Selling expense	4,500
General and administrative expense	4,000
Amortization expense	4,000

Operating profits	$ 20,000
Interest expense	2,500

Net income before taxes	$ 17,500
Taxes (40%)	7,000

Net income after taxes	$ 10,500

Magna Fax, Inc.
Balance Sheet
For the Years Ended December 31, 2002 and 2003

Assets		2003		2002
Cash		$24,000		$21,000
Accounts receivable		45,000		39,000
Inventory		30,000		27,000
Gross fixed assets	$42,000		$40,000	
Acc. amortization	22,000		18,000	
Net fixed assets		20,000		22,000
		--------		--------
Total assets		$119,000		$109,000
Liabilities and Equity				
Accounts payable		$25,000		$30,000
Notes payable		50,000		40,000
Accruals		1,000		2,000
Long-term debts		10,000		8,000
Common stock at par		5,000		5,000
Retained earnings		28,000		24,000
		--------		--------
Total liabilities and equity		$119,000		$109,000

180) The credit manager at First Nations Bank has just received the income statement and balance sheet for Magna Fax, Inc. for the year ended December 31, 2003. (See Figure 2.3) The bank requires the firm to report its earnings performance and financial position quarterly as a condition of a loan agreement. The bank's credit manager must prepare two key financial statements based on the information sent by Magna Fax, Inc. This will be passed on to the commercial loan officer assigned to this account, so that he may review the financial condition of the firm.

a. Prepare a statement of retained earnings for the year ended December 31, 2003.
b. Prepare a statement of cash flows for the year ended December 31, 2003, organized by sources of cash and uses of cash.
c. Prepare a statement of cash flows for the year ended December 31, 2003, organized by cash flow from operating activities, cash flow from investment activities, and cash flow from financing activities.

Answer: a.

Magna Fax, Inc.
Statement of Retained Earnings
For the Year Ended December 31, 2003

Retained Earnings Balance (December 31, 2002)	$24,000
Net income after taxes	+ 10,500
Dividends	- 6,500
------------------------------	--------
Retained Earnings Balance (December 31, 2003)	$28,000

b.

Magna Fax, Inc.
Statement of Cash Flows
For the Year Ended December 31, 2003

SOURCES		USES	
Net income		Dividends paid	$6,500
after taxes	$10,500	Inc. in Cash	3,000
Amortization	4,000	Inc. in Acct. rec	6,000
Inc. in Notes payable	10,000	Inc. in Inventory	3,000
Inc. in LT debts	2,000	Inc. in Fixed asset	2,000
Dec. in Acct payable	5,000	Dec. in Accruals	1,000
Total Sources	$26,500	Total Uses	$26,500

c.

Magna Fax, Inc.
Statement of Cash Flows
For the Year Ended December 31, 2003

Cash flow from operating activities:

Net income after taxes	$10,500	
Amortization	4,000	
Inc. in Accounts receivable	- 6,000	
Inc. in Inventory	- 3,000	
Dec. in Accounts payable	- 5,000	
Dec. in Accruals	- 1,000	
	---------	-$ 500

Cash flow from investment activities:

Inc. in Gross fixed assets	- 2,000	
Changes in business interest	0	
	--------	-$2,000

Cash flow from financing activities:

Answer:	Inc. in Notes payable	$10,000	
	Inc. in LT debts	2,000	
	Changes in S.E.	0	
	Dividends paid	- 6,500	
		--------	$5,500

	Net increase in cash & marketable sec.		$3,000

Answer Key
Testname: C2

1) C
2) D
3) C
4) C
5) D
6) A
7) B
8) A
9) B
10) B
11) B
12) A
13) D
14) C
15) D
16) A
17) A
18) B
19) C
20) D
21) C
22) B
23) D
24) B
25) A
26) B
27) A
28) C
29) C
30) D
31) A
32) C
33) B
34) C
35) A
36) B
37) A
38) B
39) D
40) D
41) D
42) D
43) D
44) B
45) D
46) D
47) B
48) C
49) C
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51) B
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82) A
83) C
84) D
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94) B
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99) D
100) B

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102) D
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105) C
106) C
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161) FALSE
162) FALSE
163) FALSE
164) FALSE
165)

Year	Opening UCC	Net Additions	CCA	Ending UCC
2003		$120,000	$18,000	$102,000
2004	$102,000		30,600	71,400
2005	71,400		21,420	49,980
2006	49,980		14,994	34,986
2007	34,986		10,496	24,490

Recapture = (40,000 - 24,490) = $15,510

166)

Earnings before interest and taxes	$500,000
Less: Interest	10,000

Earnings before taxes	$490,000
Less: Taxes (40%)	196,000

Earnings after taxes	$294,000

167) a.

Sales revenue	$85,000
- cost of goods sold	- 50,000
-------------------	--------
gross profits	$35,000

b.

Gross profits		$35,000
- operating expenses		
selling expense	4,000	
general & adm. expense	7,500	
depreciation expense	5,000	
---------------------	--------	
		$16,500

Operating profits		$18,500

c.

Operating profits	$18,500
- interest expense	- 3,500
--------------------	--------

net profits before taxes $15,000

d.

net profits before taxes	$15,000
- taxes (40%)	- 6,000
--------------------	--------
net profits after taxes	$ 9,000

e.

net profits after taxes	$ 9,000
+ depreciation expense	+ 5,000
---------------------	--------
cash flow from operations	$14,000

f.

net profits after taxes	$ 9,000
- preferred dividends	- 500
---------------------	--------
earnings available for C.S.	$ 8,500

g.

$$\frac{\text{earnings available for C.S.}}{\text{\# of common shares outstanding}} = \frac{\$8,500}{5,000} = \$1.70/\text{share}$$

168) Dividends = ($3.50/share) (35,000 shares) = $122,500

Retained Earnings (2001)	$485,000
Net Income After Taxes (2002)	X
Dividends	122,500
-----------------------	--------
Retained Earnings (2002)	$565,000

Net Profits After Taxes = $202,500

169)

Asset		Tax Liability
1	$2,000(.40)(0.5)	= $400
2	---	
3	$12,500(.40)(0.5)	= $2,500
4	$500(.40)(0.5)	= $100
5	---	

170) 1) The historical cost principle is objective and conservative, but does not reflect market realities.
2) Items like goodwill, human capital, competitive advantages, and growth options are not accounted for in the financial statements.

171)

Retained Earnings (2001)	$850,000
Net Profits After Taxes (2002)	245,000
Preferred Stock Dividend	(45,000)
Common Stock Dividend	X
-----------------------	--------
Retained Earnings (2002)	$950,000

Total common stock dividend = $100,000
Common stock dividend per share = 100,000/10,000 = $10

172) a.

Year	Taxable Earnings	CB/CF	Cumulative Earnings	Adjusted
1996	$ 400,000	$	$	$
1997	500,000			
1998	600,000	600,000	600,000	
1999	400,000	400,000	1,000,000	0
2000	300,000	300,000	1,300,000	0
2001	-1,500,000			
2002	500,000	200,000	1,500,000	0

b. Tax refund in 2001:
($1,300,00)(0.40) = $520,000

c.

Carryforward to 2002:		= $200,000
Taxable earnings:	$500,000 - $200,000	= $300,000
Tax liability:	($300,000)(0.40)	= $120,000

173) a. OCF = EBIT - Taxes + Depreciation

OCF = $30,000 - $8,000 + $3,000 = $35,000

b. FCF = OCF - Net fixed asset investment (NFAI) - Net current asset investment (NCAI)

NFAI = Change in net fixed assets + Depreciation
= (24,000 - 22,000) + 3,000 = $5,000

NCAI = Change in current assets - change in (Accounts payable + Accruals)
= (99,000 - 87,000) - (32,000 - 26,000)
= $6,000

FCF = 35,000 - 5,000 - 6,000 = $24,000

174)

Administrative expenses........................	O
Rent payment...	O
Interest on a note payable......................	F
Interest on a note receivable..................	F
Sale of equipment....................................	I
Dividend payment..................................	F
Stock repurchase.....................................	F
Sale of finished goods.............................	O
Labor expense..	O
Sale of a bond issue................................	F
Repayment of a long-term debt............	F
Selling expenses.......................................	O
Depreciation expense..............................	O
Sale of common stock..............................	F
Purchase of fixed assets..........................	I

175) ABC confectionery Limited
Statement of Changes in Financial Position
For the year ended December 31, 2003

Operating Activities:	
Net Income	$108,000
Add:	
Inventory (decrease)	6,000
Accounts Payable (increase)	7,500
Taxes Payable (increase)	32,000
Depreciation Expense	10,400
Deduct:	
Accounts Receivable (increase)	(2,000)
Interest Payable (decrease)	(1,000)

Net Cash Flow from Operating Activities	$160,900
Investing Activities:	
Net purchases of Fixtures and Equipment	$(10,000)

Net Cash Flow from Investing Activities	$(10,000)
Financing Activities:	
Principal paid on Business Loan	$(10,000)
Principal paid on Mortgage	(2,500)
Dividends paid to shareholders	(120,000)
Issuance of shares	2,500

Net Cash Flow from Financing Activities	$(130,000)

Net Increase in Cash	$ 20,900

176) ABC Corp.
Balance Sheet Changes and Classification
of Key Accounts between 2002 and 2003

Account	2003	2002	Chng	Classif.	Type
Long-term debts	$ 960	$ 800	+160	S	F
Accounts receivable	640	500	+140	U	O
Common stock	200	200	0	N	F
Cash	640	500	+140	U	O
Retained earnings	960	800	+160	S	O/F
Accruals	50	200	-150	U	O
Inventory	840	600	+240	U	O
Accounts payable	1,150	1,000	+150	S	O
Net fixed assets	1,800	2,000	-200	S	I

177) Depreciation Schedule

Year	Depreciation Expense	
1	$300,000	× .10 = 30,000
2	$270,000	× .20 = 54,000
3	$216,000	× .20 = 43,200
4	$172,800	× .20 = 34,560
5	$138,240	× .20 = 27,648

178)

Net Profits Before Taxes	$354,000
Less: Taxes (26%)	92,040

Net Profits After Taxes	$261,960

Retained Earnings (2001)	$338,000
Net Profits After Taxes (2002)	261,960
Dividends	X
------------------------	--------
Retained Earnings (2002)	$389,000

Dividends = $210,960

179) a.

Gross Profits	$1,000,000
Less: Operating expenses	(345,000)

Operating Profits	$ 655,000
Less: Interest	(125,000)

Net Profits before taxes	$ 530,000
Less: Taxes (30%)	(159,000)

Net Profits After Taxes	$ 371,000
Less: Preferred Stock Dividend	(57,000)

Earnings Available for Common Stock	$ 314,000

b.

Earnings Available for Common Stock	$ 314,000
Dividend = (4.25)(15,000 shares)	(63,750)

Increased Retained Earnings	$ 250,250

180) a.

Magna Fax, Inc.
Statement of Retained Earnings
For the Year Ended December 31, 2003

Retained Earnings Balance (December 31, 2002)	$24,000
Net income after taxes	+ 10,500
Dividends	- 6,500
-------------------------------	--------
Retained Earnings Balance (December 31, 2003)	$28,000

b.

Magna Fax, Inc.
Statement of Cash Flows
For the Year Ended December 31, 2003

SOURCES		USES	
Net income after taxes	$10,500	Dividends paid	$6,500
		Inc. in Cash	3,000
Amortization	4,000	Inc. in Acct. rec	6,000
Inc. in Notes payable	10,000	Inc. in Inventory	3,000
Inc. in LT debts	2,000	Inc. in Fixed asset	2,000
Dec. in Acct payable	5,000	Dec. in Accruals	1,000
Total Sources	$26,500	Total Uses	$26,500

c.

Magna Fax, Inc.
Statement of Cash Flows
For the Year Ended December 31, 2003

Cash flow from operating activities:

Net income after taxes	$10,500	
Amortization	4,000	
Inc. in Accounts receivable	- 6,000	
Inc. in Inventory	- 3,000	
Dec. in Accounts payable	- 5,000	
Dec. in Accruals	- 1,000	
	---------	-$ 500

Cash flow from investment activities:

Inc. in Gross fixed assets	- 2,000	
Changes in business interest	0	
	--------	-$2,000

Cash flow from financing activities:

Inc. in Notes payable	$10,000	
Inc. in LT debts	2,000	
Changes in S.E.	0	
Dividends paid	- 6,500	
	--------	$5,500

Net increase in cash & marketable sec.		$3,000