# Test Bank for Foundations of Financial Management CDN 11th Block

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# Chapter 02
# Review of Accounting

## Multiple Choice Questions

1. Which of the following is not one of the four basic financial statements required by Accounting Standards for Private Enterprises (ASPE)?
A. Income Statement
**B.** Statement of Financial Position
C. Statement of Cash Flows
D. Balance Sheet

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-01 Accounting for Information*

2. Which of the following would not be classified as a current asset?
A. Marketable securities
**B.** Long term Investments
C. Prepaid expenses
D. Inventory

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



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3. An item that may be converted to cash within one year or one operating cycle of the firm is classified as a:
A. current liability.
B. long-term asset.
**C.** current asset.
D. long-term liability.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-08 Statement of Cash Flows*

4. Which of the following is not a primary source of capital to the firm?
**A.** Assets
B. Common stock
C. Preferred stock
D. Bonds

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*

5. The residual income of the firm belongs to:
A. creditors.
B. preferred shareholders.
**C.** common shareholders.
D. bondholders.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



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6. The best indication of the operational efficiency of management is:
A. net income.
B. earnings per share.
**C.** earnings before interest and taxes (EBIT).
D. gross profit.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

7. Which account represents the cumulative earnings of the firm since its formation, minus dividends paid?
A. Share price
B. Common stock
**C.** Retained earnings
D. Accumulated amortization

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

8. A firm has $3,500,000 in its common stock account and $2,500,000 in its retained earnings account. The firm issued 100,000 shares of common stock. What was the original issue price if only one stock issue has ever been sold?
**A.** $35 per share
B. $25 per share
C. $60 per share
D. Not enough information to tell

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



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9. A firm has $2,000,000 in its common stock account and $20,000,000 in its retained earnings account. The firm issued 500,000 shares of common stock. What are accumulated earnings per share?
A. $4 per share
B. $44 per share
**C.** $40 per share
D. $5 per share

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

10. The major limitation of financial statements is:
A. in their complexity.
B. in their lack of comparability.
**C.** in their use of historical cost accounting.
D. in their lack of detail.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*

11. Inflation has its major impact on balance sheets in which of the following areas?
A. Inventory and accounts payable
B. Plant and equipment and long-term debt
**C.** Plant and equipment and inventory
D. Interest expense and earnings per share

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*



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12. "Inventory profits" are most likely to occur in an inflationary economy under which of the following inventory cost assumptions?
A. Weighted average
B. Specific item
**C.** FIFO
D. Lower of cost or market

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*

13. The orientation of book value per share is _____, while the orientation of market value per share is _____.
A. short term; long term
B. future; historical
**C.** historical; future
D. long term; short term

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

14. A firm with earnings per share of $5 and a price-earnings ratio of 15 will have a share price of?
A. $20.00
**B.** $75.00
C. $3.00
D. The market assigns a stock price independent of EPS and the P/E ratio

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*



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15. Earnings per share is:
A. operating profit divided by number of shares outstanding.
B. net income divided by number of shares outstanding.
C. net income divided by shareholders' equity.
**D.** net income minus preferred dividends divided by number of shares outstanding.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

16. Which of the following is an outflow of cash?
A. Profitable operations
B. The sale of equipment
C. The sale of the company's common stock
**D.** The payment of cash dividends

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

17. Which of the following is an inflow of cash?
A. Funds spent in normal business operations
B. The purchase of a new factory
**C.** The sale of the firm's bonds
D. The retirement of the firm's bonds

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*



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18. Amortization is a source of cash inflow because:
**A.** it is a tax-deductible noncash expense.
B. it supplies cash for future asset purchases.
C. it is a tax-deductible cash expense.
D. it is a taxable expense.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

19. Assuming a tax rate of 35%, amortization expenses of $400,000 will:
A. reduce income by $140,000.
**B.** reduce taxes by $140,000.
C. reduce taxes by $400,000.
D. have no effect on income or taxes, since amortization is not a cash expense.

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-24 Amortization (Capital Cost Allowance) as a Tax Shield*

20. Assuming a tax rate of 30%, the after tax cost of interest expense of $200,000 is:
A. $60,000.
**B.** $140,000.
C. $200,000.
D. $120,000.

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-23 Cost of a Tax-deductible Expense*



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21. Gross profit is equal to:
**A.** sales minus cost of goods sold.
B. sales minus (selling and administrative expenses).
C. sales minus (cost of goods sold and selling and administrative expenses).
D. sales minus (cost of goods sold and amortization expense).

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

22. The firm's price-earnings (P/E) ratio is not influenced by its:
A. capital structure.
B. earnings volatility.
C. sales, profit margins, and earnings.
**D.** Purchase of machinery.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

23. Total shareholders' equity consists of:
A. preferred stock and common stock.
B. common stock and retained earnings.
C. common stock and contributed surplus.
**D.** preferred stock, common stock, contributed surplus, and retained earnings.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*



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24. The Balance Sheet cannot show:
A. the current ratio.
B. the value of common stock outstanding.
C. the change in retained earnings.
**D.** the price earnings relationship.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*

25. Well prepared accounting statements:
**A.** let management know if cash flow from internal operations is large enough to make necessary equipment replacements.
B. provide no new information to financial managers.
C. determine the market price of common stock.
D. eliminate the effects of inflation from decision making.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*

26. The Glorious Vander Built Denim Slacks Company has taxable income of $100,000. Assuming a 34% tax rate, what is the tax payable?
**A.** $34,000
B. $66,000
C. $100,000
D. $12,250

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-06 Outline the effect of corporate tax considerations on aftertax cash flow.*
*Topic: 02-20 Corporate Tax Rates*



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27. Book value of a firm:
A. is usually the same as the firm's market value.
B. is based on current asset costs.
**C.** is the same as net worth.
D. none of the choices are correct.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

28. A statement of cash flows allows a financial analyst to determine:
A. whether a cash dividend is affordable.
B. how increase in asset accounts have been financed.
C. whether long-term assets are being financed with long-term or short-term financing.
**D.** all of the choices are correct.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

29. A firm has $200,000 in current assets, $400,000 in long-term assets, $80,000 in current liabilities, and $200,000 in long-term liabilities. What is its net working capital?
**A.** $120,000
B. $320,000
C. $520,000
D. None of the choices are correct

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



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30. A firm has current assets of $25,000, long term assets of $100,000, long term liabilities of $50,000, and $50,000 in shareholders' equity. What is its net working capital?
**A.** $0
B. $50,000
C. $100,000
D. $25,000

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

31. Assuming a tax rate of 40%, the after tax cost of a $200,000 dividend payment is:
**A.** $200,000.
B. $70,000.
C. $130,000.
D. None of the choices are correct

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-07 Identify the different forms of investment income and the effects on investors' taxes payable.*
*Topic: 02-22 Personal Taxes*

32. Which of the following would not be included in the balance sheet investment account?
A. Shares of other corporations
B. Long term government bonds
**C.** Marketable securities
D. Investments in other corporations

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



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33. Which of the following is not true of current cost accounting?
A. The book value of equipment is near replacement value
**B.** The book value of the common stock equals market value
C. Dividends and income are adjusted for inflation
D. All of the choices are correct

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*

34. The primary disadvantage of accrual accounting is that:
A. it does not match revenues and expenses in the period in which they are incurred.
B. it does not appropriately measure accounting profit.
C. it does not recognize the actual exchange of cash.
**D.** it does not adequately show the actual cash flow position of the firm.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

35. The statement of cash flows does not include which of the following sections?
A. Cash flows from operating activities
**B.** Cash flows from sales activities
C. Cash flows from investing activities
D. Cash flows from financing activities

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-12 Determining Cash Flows from Financing Activities*



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36. Which of the following would represent a use of funds and, indirectly, a reduction in cash balances?
**A.** An increase in inventories.
B. A decrease in marketable securities.
C. An increase in accounts payable.
D. The sale of new bonds by the firm.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

37. Which of the following would represent a source of funds and, indirectly, an increase in cash balances?
**A.** A reduction in accounts receivable.
B. The repurchase of shares of the firm's stock.
C. A decrease in net income.
D. A reduction in notes payable.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

38. A firm's purchase of plant and equipment would be considered as a:
A. use of cash for financing activities.
B. use of cash for operating activities.
C. source of cash for investment activities.
**D.** use of cash for investment activities.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*



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39. Reinvested funds from retained earnings theoretically belong to:
A. bondholders.
**B.** common shareholders.
C. employees.
D. all of the choices are correct.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*

40. For private companies, asset accounts on the balance sheet are listed in the order of:
**A.** liquidity.
B. profitability.
C. size.
D. importance.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

41. An increase in investments in long-term securities will:
A. increase cash flow from investing activities.
**B.** decrease cash flow from investing activities.
C. increase cash flow from financing activities.
D. decrease cash flow from financing activities.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*



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42. Free cash flow is equal to cash flow from operating activities:
A. plus capital expenditures, minus dividends.
B. plus capital expenditures, plus dividends.
C. plus dividends, minus capital expenditures.
**D.** minus capital expenditures, minus dividends.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*

43. In the last decade, free cash flow has been associated with special financial activities such as:
**A.** leveraged buyouts.
B. Registered Retirement Savings Plan (RRSPs).
C. stock options.
D. golden parachutes.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*

44. Common stock dividends are _____ by preferred stock dividends.
A. increased
**B.** decreased
C. not effected
D. Not enough information to tell

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*



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45. Increasing interest expense will have what effect on EBIT?
A. Increase it
B. Decrease it
**C.** No effect
D. Not enough information to tell

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

46. When a firm's earnings are falling more rapidly than its stock price, its P/E ratio will:
A. remain the same.
**B.** go up.
C. go down.
D. could go either up or down.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

47. Net worth is equal to shareholders' equity:
A. plus dividends.
**B.** minus preferred stock.
C. plus preferred stock.
D. minus liabilities.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



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48. Net worth for an individual is the same as _____ for a corporation.
A. shareholders' equity
B. capital assets minus long-term debt
**C.** book value
D. current assets minus current debt

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

49. Amortization tends to:
**A.** increase cash flow and decrease income.
B. decrease cash flow and increase income.
C. affect only cash flow.
D. affect only income.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-17 Effects of IFRS on Financial Analysis*

50. Accrual based accounting results in income and cash flow being:
A. the same.
**B.** different.
C. equal except for amortization.
D. equal except for dividends.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-17 Effects of IFRS on Financial Analysis*



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51. The P/E ratio is determined by:
A. net worth divided by earnings.
B. market capitalization divided by dividend.
C. net worth per share divided by earnings per share.
**D.** market value per share divided by earnings per share.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

52. A balance sheet valuation measure is:
A. earnings per share.
B. the P/E ratio.
C. the dividend yield.
**D.** market value to book value.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

53. Preferred share dividends _____ earnings available to common shareholders.
A. increase
**B.** decrease
C. due not effect
D. not enough information to tell

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*



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54. Which of the following is not subtracted to arrive at operating profit?
**A.** Interest expense
B. Cost of goods sold
C. Amortization
D. Selling and administration expense

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

55. Given the following what is free cash flow?

| | |
|---|---|
| Cash flow from operations | $175,000 |
| Capital expenditures | 35,000 |
| dividends | 25,000 |

**A.** $115,000
B. $235,000
C. $150,000
D. $140,000

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*



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56. All of the following would be included in Cash Flows from Investing, except:
A. investments in Plant.
**B.** merchandise Purchases.
C. purchases of Investments.
D. sale of Long-Term Investments.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-14 Amortization and Cash Flow*

57. An item that must be paid within one year or one operating cycle of the firm is classified as a:
**A.** current liability.
B. long-term asset.
C. current asset.
D. None of the choices are correct.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

58. Assuming no conversion rights of bond holders or preferred shareholders, the retained earnings of the firm belongs to:
A. creditors.
B. preferred shareholders.
**C.** common shareholders.
D. Canada Revenue Agency.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

59. A firm has $7,500,000 in its common stock account and $2,500,000 in its retained earnings account. The firm issued 100,000 shares of common stock. What was the original issue price if only one stock issue has ever been sold?
**A.** $75 per share
B. $25 per share
C. $100 per share
D. Not enough information to tell

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

60. Assuming a tax rate of 35%, amortization expenses of $800,000 will:
A. reduce income by $280,000.
**B.** reduce taxes by $280,000.
C. reduce taxes by $800,000.
D. have no effect on income or taxes, since amortization is not a cash expense.

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-24 Amortization (Capital Cost Allowance) as a Tax Shield*

61. Assuming a tax rate of 30%, the after tax cost of interest expense of $400,000 is:
A. $120,000.
**B.** $280,000.
C. $400,000.
D. $240,000.

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-23 Cost of a Tax-deductible Expense*

**True / False Questions**



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62. The income statement is the primary financial statement for measuring the profitability of a firm over a period of time.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

63. The income statement measures the increase in the assets of a firm over a period of time.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

64. Accounting income is based on verifiably completed transactions.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

65. For private companies, asset accounts are listed in order of their liquidity.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

66. Book value per share and market value per share are usually the same dollar amount.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

67. Book value per share is of greater concern to the financial manager than market value per share.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

68. Book value is equal to net worth.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

69. Equity is a measure of the monetary contributions that have been made directly or indirectly on behalf of the shareholders of the company.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

70. Shareholders' equity is equal to liabilities plus assets.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

71. Shareholders' equity is equal to assets minus liabilities.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

72. Shareholders' equity minus preferred stock is the same thing as what is sometimes called net worth or book value.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

73. The statement of cash flows helps measure how the changes in a balance sheet are financed between two time periods.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

74. An increase in an asset represents a source of funds.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

75. Accumulated amortization shows up in the income statement.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-17 Effects of IFRS on Financial Analysis*

76. The change in accumulated amortization is usually equal to the amortization expense charged in the income statement.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-17 Effects of IFRS on Financial Analysis*

77. Net working capital is the difference between current assets and current liabilities.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

78. Amortization is an accounting entry and does not involve a cash expense.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-17 Effects of IFRS on Financial Analysis*

79. An advantage of the net working capital approach over the cash approach is that it looks at the changes of every account of the statement of cash flows.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

80. Cash flow is equal to earnings before taxes minus amortization.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

81. The corporate tax rate is 25% on the first $200,000 of income and 50% on any amount over $200,000.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-06 Outline the effect of corporate tax considerations on aftertax cash flow.*
*Topic: 02-20 Corporate Tax Rates*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

82. Interest expense is deductible before taxes and therefore has an after tax cost equal to the interest paid times (1-tax rate).
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-24 Amortization (Capital Cost Allowance) as a Tax Shield*

83. Preferred stock dividends are paid out before income taxes.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

84. Total assets of a firm are financed with liabilities and shareholders' equity.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

85. Retained earnings shown on the balance sheet represents available cash on hand generated from prior year's earnings but not paid out in dividends.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

86. Current cost accounting adjusts financial statements by using the consumer price index.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-07 Limitations of the Balance Sheet*

87. An increase in a liability account represents a source of funds.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

88. The statement of cash flows includes the effects of dividends paid and amortization expense.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

89. The net working capital approach to funds flow analysis looks at the difference between total assets and total liabilities.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

90. The marginal corporate tax rate for incomes over $1,000,000 is 50%.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-06 Outline the effect of corporate tax considerations on aftertax cash flow.*
*Topic: 02-20 Corporate Tax Rates*

91. Preferred stock is always excluded from shareholders' equity because it is a hybrid security and does not have full voting rights.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*

92. Current cost accounting undervalues plant and equipment because it does not adjust for inflation.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

93. The investments account includes marketable securities.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

94. The investments account represents a commitment of funds of at least one year.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

95. A $125,000 credit sale could be a part of a firm's cash flow from operations if paid off within a firm's fiscal year.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

96. An increase in accounts receivable represents a reduction in cash flows from operations.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

97. An increase in accounts payable represents a reduction in cash flows from operations.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

98. The purchase of a new factory would reduce the cash flows from investing activities.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-14 Amortization and Cash Flow*

99. The sale of corporate bonds held by the firm as a long-term investment would increase cash flows from investing activities.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-15 Free Cash Flow*

100. Paying dividends to common shareholders will not affect cash flows from financing activities.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-14 Amortization and Cash Flow*

101. It is not possible for a company with a high profit margin to have a low operating profit.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

102. Operating profit is essentially a measure of how efficient management is in generating revenues and controlling expenses.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*

103. The P/E ratio provides no indication of investors' expectations about the future of a company.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

104. The real value of a firm is the same in an economic and accounting sense.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

105. A balance sheet represents the assets, liabilities, and shareholders' equity of a company at a given point in time.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-02 Examine the limitations of the income statement as a measure of a firm's profitability.*
*Topic: 02-06 Balance Sheet*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

106. Balance sheet items are usually adjusted for inflation.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-02 Examine the limitations of the income statement as a measure of a firm's profitability.*
*Topic: 02-06 Balance Sheet*

107. Marketable securities are temporary investments of excess cash and are carried at the lower of cost or market.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

108. Retained earnings represent the firm's cumulative earnings since inception, minus dividends and other adjustments.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

109. Cash flow consists of illiquid cash equivalents which are difficult to convert to cash within 90 days.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-14 Amortization and Cash Flow*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

110. The sale of a firm's securities is a source of funds, whereas the payment of dividends is a use of funds.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-15 Free Cash Flow*

111. The use of amortization is an attempt to allocate the past and future cost of an asset over its useful life.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-17 Effects of IFRS on Financial Analysis*

112. Free cash flow is equal to cash flow from operating activities plus amortization.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*

113. Free cash flow is equal to cash flow from operating activities minus necessary capital expenditures and normal dividend payments.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

114. Taxes on individuals have traditionally been progressive, meaning that the more taxable income you have, the higher your marginal tax rate.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-07 Identify the different forms of investment income and the effects on investors' taxes payable.*
*Topic: 02-22 Personal Taxes*

115. The P/E ratio is strongly related to the past performance of the firm.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

116. An increase in assets represents a source of funds.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

117. Sales less cost of goods sold is equal to earnings before taxes.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

118. Sales less cost of goods sold is equal to gross profit.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

119. When a firm has a sharp drop off in earnings, its P/E ratio may be artificially high.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

120. The investments account does not directly affect cash and cash equivalents.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

121. Amortization expense is charged in the income statement.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

122. An increase in inventory represents a source of funds.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*

123. The income statement allows analysts and investors to measure a firm's profitability of over a period of a month, quarter or year.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

124. Earnings available to common shareholders includes potential dividends to be paid to preferred shareholders.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*

125. The effective tax rate on dividend income is lower than interest income because of the dividend tax credit (DTC). Canadians are allowed to claim the DTC because the government wants to reduce the effects of double taxation.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-07 Identify the different forms of investment income and the effects on investors' taxes payable.*
*Topic: 02-22 Personal Taxes*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

126. Prior Adjustments may be added or subtracted from a firm's Retained Earnings. These "adjustments" are usually for accounting errors or substantive changes to historical cost of assets or liabilities.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-03 Return on Capital*

127. Preferred and/or Common Share dividends are added to Cash Flow from Operations in determining Free Cash Flow.
**FALSE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*

128. The sale of a firm's preferred shares is a source of funds, whereas the payment of preferred dividends is a use of funds.
**TRUE**

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-15 Free Cash Flow*

## Short Answer Questions



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

129. What is an income statement and what is its purpose as it relates to financial management?

The income statement

• Measures the profitability of a firm over a time period (month, year)
• Assists financial decision making and analysis, utilizing past patterns for predicting the timing, uncertainty, and amount of future earnings and cash flows.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

130. What is the P/E ratio? Why is it an important ratio? List 3 factors that influence the P/E ratio.

The P/E ratio is Market share price/Earnings per share. This ratio allows comparison of the relative market value of many companies on the basis of $1 of earnings per share. Firms expected to provide greater than average future returns often have P/E ratios higher than the market average P/E ratio. As investors' expectations for future returns change, a company's P/E ratio can shift substantially.
The price/earnings ratio (P/E ratio) of a firm is influenced by

• Earnings and sales growth
• Risk (business performance and debt-equity structure)
• Dividend payment policy
• Quality of management
• Many other factors

*Accessibility: Keyboard Navigation*
*Blooms: Understand*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

131. In the text, the author said that "Earnings are flexible." What was meant by this?

In efforts to meet earnings targets, accountants and managers had resorted to stretching accounting standards beyond their reasonable limits. Earnings can be managed or "manipulated" because professional accounting bodies allow latitude. Accruals, such as allowance for doubtful accounts or warranty expenses, and write-downs of assets (inventories and capital) are by their nature discretionary. Margins can also be managed, by classification of "overhead" as a cost of goods rather than administrative expenses. Management has this discretion due to its experience and the need to make estimates of many of the revenues and expenses that will flow through the firm.

*Accessibility: Keyboard Navigation*
*Blooms: Understand*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*
*Topic: 02-03 Return on Capital*
*Topic: 02-04 Valuation Basics from the Income Statement*

132. Several theories have been suggested about the factors contributing to the management or "manipulation" of reported earnings. List and explain them.

• Bonuses (Compensation is tied to reported earnings.)
• Political considerations (High reported earnings attract societal attention.)
• Smoothing (Less volatile earnings are viewed favourably by the market.)
• Debt covenants (Debt contracts are often based on book value calculations.)
• Big bath (New CEOs will look better in the future if assets are written down as they take over, avoiding future amortization charges.)

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-02 Examine the limitations of the income statement as a measure of a firm's profitability.*
*Topic: 02-04 Valuation Basics from the Income Statement*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

133. Explain these terms found on a typical balance sheet. Provide examples of each if applicable.

Marketable securities, Accounts receivable, Inventory, Prepaid expenses, Investments, Plant and equipment, Accumulated amortization, Accounts payable, Notes payable, Accrued expense, Shareholders' equity.

**Marketable securities** are temporary investments of excess cash (lower of cost or current market value).
**Accounts receivable** include an allowance for bad debts (based on historical evidence) to suggest their anticipated collection value.
**Inventory** may be in the form of raw material, goods in process, or finished goods.
**Prepaid expenses** represent future expenses that have already been paid (insurance premiums, rent).
**Investments**, unlike marketable securities, are a longer-term commitment of funds, including stocks, bonds, or investments in other corporations (often for acquisition).
**Plant and equipment** is identified as original cost minus accumulated amortization.
**Accumulated amortization** is the sum of all past and present amortization charges on currently owned assets, whereas amortization expense is the current year's charge.
**Accounts payable** represent amounts owed on open account to suppliers.
**Notes payable** are generally short-term signed obligations to the banker or other creditors.
**Accrued expense** is an obligation incurred but payment has not yet occurred (additional wages for services provided and owed workers).
**Shareholders' equity** represents the total contribution and ownership interest of preferred and common shareholders.

*Accessibility: Keyboard Navigation*
*Blooms: Understand*
*Difficulty: Medium*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

134. List and describe the limitations of the balance sheet.

The values on the balance sheet are often subject to interpretation or revaluation.

• Values are stated on a historical or original cost basis, not market values (some assets may be worth considerably more than their original cost or may require many times the original cost for replacement).
• Accounting policy choice, which should be disclosed in the financial notes, will influence the recorded values.
• Contingent liabilities omitted from the balance sheet, or items such as intangibles that are included, may have a hard-to-determine influence on economic value. Contingent liabilities should be disclosed in footnotes on the balance sheet, alerting us to their possible impact.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Medium*
*Learning Objective: 02-03 Examine the limitations of the balance sheet as a measure of a firm's financial position.*
*Topic: 02-10 Determining Cash Flows from Operating Activities*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

135. What is a cash flow statement? What information can it provide? Why is a cash flow statement important to small business?

The cash flow statement reports changes in cash and cash equivalents (rather than working capital) resulting from the activities of the firm during a given period.
For many internal and external users of a firm's financial information, cash flow information is critical.

The cash flow statement allows an analyst to identify

• Cash flow generated from the firm's assets
• Financial obligations (interest and dividends)
• Commitment to new assets

The statement of cash flows can highlight

• The relative build up in short-term and long-term assets
• The means of financing used to support any growth in the firm's asset base
• The appropriateness and the future implications of the financing used

The cash flow statements for the small business are particularly important, as cash flow is more relevant to the firm's short-term survival than its reported income. One is likely to be concerned about the quality, timing, and amount of earnings, and hence the firm's ability to acquire assets and meet its obligations. In the very competitive corporate environment of today exacting cash flow analysis is essential for a firm's survival.

*Accessibility: Keyboard Navigation*
*Blooms: Understand*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

136. List the 3 primary sections on the cash flow statement.

These sections are:

1. Operating activities
2. Investing activities
3. Financing activities

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-11 Determining Cash Flows from Investing Activities*

137. Describe and briefly explain the steps used in the indirect method to compute cash flows from typical operating activities of a company.

We follow these procedures to **compute cash flows from operating activities** using the indirect method.

• Start with net income.
• Recognize that noncash deductions in computing net income should be added back to net income to *increase* the cash balance. These include such items as amortization, deferred income taxes, restructuring charges, and foreign exchange losses. **This produces cash flow from operations**.
• Next identify changes in noncash working capital.
• Recognize that increases in current assets are a use of funds and *reduce* the cash balance (indirectly)—as an example, the firm spends more funds on inventory.
• Recognize that decreases in current assets are a source of funds and *increase* the cash balance (indirectly)—that is, the firm reduces funds tied up in inventory.
• Recognize that increases in current liabilities are a source of funds and *increase* the cash balance (indirectly)—that is, the firm gets more funds from creditors.
• Recognize that decreases in current liabilities are a use of funds and *decrease* the cash balance (indirectly)—that is, the firm pays off creditors.

*Accessibility: Keyboard Navigation*
*Blooms: Understand*
*Difficulty: Hard*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-13 Combining the Three Sections of the Statement*



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138. Define free cash flow. Explain what it is equal to and why it is important a finance manager needs to know the value of free cash flow.

Free cash flow is equal to:

Cash flow from operating activities

Minus: Capital expenditures (required to maintain the productive capacity of the firm)
Minus: Dividends (needed to maintain the necessary payout on common stock and to cover any preferred stock obligation)

The concept of free cash flow forces the stock analyst or banker not only to consider how much cash is generated from operating activities, but also to subtract out the necessary capital expenditures on plant and equipment to maintain normal activities. Similarly, dividend payments to shareholders must be subtracted out, as these dividends must generally be paid to keep shareholders satisfied. The balance, free cash flow, is then available for *special financial activities*. In the last decade, special financing activities have often been synonymous with leveraged buyouts, in which a firm borrows money to buy its stock and take itself private with the hope of restructuring its balance sheet and perhaps going public again in a few years at a higher price than it paid. The analyst or banker normally looks at *free cash flow* to determine whether there are sufficient excess funds to pay back loans associated with special financial activities.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Hard*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-18 Interpretation of Balance Sheet Items*

139. What causes the after tax cash flow to the individuals to vary?

The after tax cash flow to the individual varies depending on whether investment income is in the form of interest, dividends, or capital gain. (Highest to lowest marginal tax rate.)

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-07 Identify the different forms of investment income and the effects on investors' taxes payable.*
*Topic: 02-22 Personal Taxes*



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140. What is a tax savings?

A tax savings is the reduction of taxes otherwise payable as a result of an allowable deduction of an expense from taxable income.

*Accessibility: Keyboard Navigation*
*Blooms: Remember*
*Difficulty: Easy*
*Learning Objective: 02-07 Identify the different forms of investment income and the effects on investors' taxes payable.*
*Topic: 02-22 Personal Taxes*

141. Valley Home Improvements (VHI) earned $350,000 after taxes in its most recent fiscal year. If VHI's Board of Directors declared a total of $45,000 in preferred dividends what would be the total amount available to pay common shareholders?

Earnings Available to Common Shareholders (EAT) = Earnings After Taxes - Preferred Dividends

EAT = $350,000 - $45,000 = $305,000

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-02 Income Statement*

142. Two-by-Four Wood Products (TBF) report net income of $2 per share in its most recent financial statements. If TBF has no preferred shares outstanding and the market price of its stock is $4 what is TBF's P/E ratio?

$\frac{P = \$4}{E \ \$2}$

P/E = 2 times
For every $1 earned by TBF you would be paying $2 in price.

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*



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143. Jane is considering an investment in Fauna Flowers (FF). FF is trading at $33 a share. It the company's current dividend is $1.50 a share, what is FF's dividend yield?

| | | |
|---|---|---|
| Dividend Yeild | = | Divided |
| | | Price |

Dividend Yield = ($1.50/$33) × 100 = 4.55%

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Topic: 02-04 Valuation Basics from the Income Statement*

144. Blink and Wink (BW) manufactures contact lens. In its most recent fiscal year BW reported after-tax interest expense on a new bond issue of $550,000. If BW's effective tax rate is 35%, what was the firm's before tax interest expense?

| | | |
|---|---|---|
| Before Tax Interest Expense | = | $550,000 |
| | | 1 – Tax Rate |

| | | |
|---|---|---|
| Before Tax Interest Expense | = | $550,000 |
| | | 1 – .35 |

Before Tax Interest Expense = $846,154

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-23 Cost of a Tax-deductible Expense*



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

145. Cool Ties and Things (CTT) has Total Shareholder's Equity of $350,000. CTT issued $85,000 in preferred stock two years ago. If CTT has 37,000 shares issued and outstanding what is CTT's book value per share?

| | | |
|---|---|---|
| BV per Share | = | Shareholder's Equity – Value of Preferred Shares O/S |
| | | Common Share O/S |

| | | |
|---|---|---|
| BV per Share | = | $350,000 - $85,000 |
| | | 37,000 |

BV per Share = $265,000/37,000 = $7.16

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Easy*
*Learning Objective: 02-05 Identify the effects of IFRS (International Financial Reporting Standards) on financial analysis.*
*Topic: 02-08 Statement of Cash Flows*

146. The following is the December 31, 20X4 balance sheet for Epics Corporation.



Access Complete Test Bank for Foundations of Financial Management CDN 11th Block

| **Assets** | | **Liabilities** | |
|---|---|---|---|
| Cash | $70,000 | Accounts payable | $100,000 |
| Accounts receivable | 150,000 | Notes payable | 120,000 |
| Inventory | 280,000 | Bonds payable | 300,000 |
| Total current assets | 500,000 | Total liabilities | 520,000 |
| | | | |
| Plant and equipment | 1,250,000 | Equity | |
| Less: acc. amortization | 250,000 | Common stock | 500,000 |
| Net plant and Equipment | 1,000,000 | Retained earnings | 480,000 |
| | | Total equity | 980,000 |
| | | | |
| Total assets | 1,500,000 | Total liab. & equity | $1,500,000 |

Sales for 20X5 were $2,000,000, with the cost of goods sold being 55% of sales. Amortization expense was 10% of the gross plant and equipment at the beginning of the year. Interest expense was 9% on the notes payable and 11% on the bonds payable. Selling, general, and administrative expenses were $200,000 and the firm's tax rate is 40%.

A) Prepare an income statement.
B) If the dividend payout ratio for Epics is 35%, what is the value of the retained earnings account on December 31, 20X5?

| **A) Income Statement** | | **B)** | |
|---|---|---|---|
| Sales | $2,000,000 | $318,720 | Net Income |
| Less: Cost of Goods Sold | 1,100,000 | x .35 | Payout ratio |
| Gross Profit | 900,000 | $111.552 | Dividends Paid |
| Less: Selling, general and administrative expense | 200,000 | | |
| Amortization Expense | 125,000 | | |
| EBIT | 575,000 | $318,720 | Net Income |
| Less: Interest Expense (10,800 + 33,000) | 43,800 | 111,552 | Dividends Paid |
| EBT | 531,200 | 207,168 | Amount Retained |
| Less: Taxes (40%) | 212,480 | +480,000 | Retained Earnings 04 |
| Net Earnings | $318,720 | $687,168 | Retained Earnings 05 |



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*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Learning Objective: 02-08 Explain the concept of tax savings for companies.*
*Topic: 02-02 Income Statement*
*Topic: 02-03 Return on Capital*
*Topic: 02-04 Valuation Basics from the Income Statement*
*Topic: 02-23 Cost of a Tax-deductible Expense*

147. Given the financial information for the A.E. Neuman Corporation,

A) Prepare a Statement of Cash Flows for the year ended December 31, 20X5.
B) What is the dividend payout ratio?
C) If we increased the dividend payout ratio to 100%, what would happen to retained earnings?

| **A.E Neuman Corporation** | **Balance Sheet** | |
|---|---|---|
| **Assets** | **20X4** | **20X5** |
| Cash | $45,000 | $50,000 |
| Marketable Securities | 175,000 | 160,000 |
| Accounts Receivable | 240,000 | 220,000 |
| Inventories | 230,000 | 275,000 |
| Investments | 70,000 | 55,000 |
| Total current assets | $760,000 | $760,000 |
| Plant and Equipment | 1,300,000 | 1,550,000 |
| Less Accumulated Amortization | 450,000 | 600,000 |
| Net plant and Equipment | $850,000 | $950,000 |
| Total Assets | 1,610,000 | 1,710,000 |



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| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
|---|---|---|
| Accounts payable | $110,000 | $85,000 |
| Notes payable | 65,000 | 10,000 |
| Accrued Expenses | 30,000 | 5,000 |
| Income Taxes Payable | 5,000 | 10,000 |
| Bonds Payable (2016) | 800,000 | 900,000 |
| Common Stock (100,000 shares) | 200,000 | 200,000 |
| Retained Earnings | 400,000 | 500,000 |
| Total Liabilities' and Shareholders' Equity | $1,610,000 | $1,710,000 |

| A.E. Neuman Corporation<br>Income Statement<br>For the Year Ended December 31, 20X5 | |
|---|---|
| Sales | $ 5,500,000 |
| Less: Cost of Goods Sold | 4,200,000 |
| Gross Profit | 1,300,000 |
| Less: Selling, General & Administrative Expenses | 260,000 |
| Operating profit | 1,040,000 |
| Less: Amortization Expense | 150,000 |
| Earnings Before Interest and Taxes | 890,000 |
| Less: Interest Expense | 90,000 |
| Earnings Before Taxes | 800,000 |
| Less: Taxes (50%) | 400,000 |
| Net Income | $ 400,000 |

A)



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| | |
|---|---|
| **Operating Activities** | |
| Net Income (earnings after taxes) | $400,000 |
| Add items not requiring on outlay of cash: | |
| Amortization | 150,000 |
| Cash flow from operations | 550,000 |
| Change in non-cash working capital: | |
| Decrease in accounts receivable | 20,000 |
| Increase in inventories | (45,000) |
| Decrease in accounts payable | (25,000) |
| Decrease in notes payable | (55,000) |
| Decrease in accrued expenses | (25,000) |
| Increase in income taxes payable | 5,000 |
| Net Change in non-cash working capital | 125,000 |
| Cash provided by operating activities | 425,000 |
| | |
| **Investing Activities** | |
| Decrease in investments | 15,000 |
| Increase in plant & equipment | (250,000) |
| Cash used in investing activities | (235,000) |
| | |
| **Financing Activities** | |
| Increase in bonds payable | 100,000 |
| Dividends paid | (300,000) |
| Cash used in financing activities | (200,000) |
| | |
| Net increase in cash and equivalents during year | (10,000) |
| Cash and equivalents, beginning of year | 220,000 |
| Cash and equivalents, at year end | $210,000 |

B)



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| | | |
|---|---|---|
| Dividend payout ratio | = | Dividends paid, 20X5 |
| | | Net income, 20X5 |
| | = $\frac{\$300,000}{\$400,000}$ | = 0.75=75% |

C) The 20X5 value for retained earnings would decrease by $100,000. In addition, assets would have to decrease by $100,000 or other liabilities would have to increase by the same amount.

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-02 Income Statement*
*Topic: 02-03 Return on Capital*
*Topic: 02-04 Valuation Basics from the Income Statement*
*Topic: 02-12 Determining Cash Flows from Financing Activities*
*Topic: 02-13 Combining the Three Sections of the Statement*
*Topic: 02-14 Amortization and Cash Flow*
*Topic: 02-15 Free Cash Flow*
*Topic: 02-16 Income Tax Considerations*

148. Calculate the tax bill for a corporation that earned $250,000 in 20X5 in Manitoba as a manufacturer.

| Tax Rate | Incremental Income | Tax Liability |
|---|---|---|
| 13% | $250,000 | = $32,500 |

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-06 Outline the effect of corporate tax considerations on aftertax cash flow.*
*Topic: 02-20 Corporate Tax Rates*



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149. Calculate the after tax cost of the interest. Assume the company has issued 10,000 bonds with a coupon rate of 8% and a face value of $1,000 per bond, and the company has a marginal tax rate of 42%.

| | | |
|---|---|---|
| Annual interest | = | 10,000 × $1,000 × 8% |
| | = | $800,000 |
| After tax cost | | $800,000 × (1 – tax rate) |
| | = | $800,000 × (1 – 42) |
| | = | $464,000 |

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-06 Outline the effect of corporate tax considerations on aftertax cash flow.*
*Topic: 02-21 Effective Tax Rate Examples*



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150. ElectroWizard Company produces a popular video game called Destructo, which sells for $32. Last year ElectroWizard sold 50,000 Destructo games, each of which costs $6 to produce. ElectroWizard incurred selling and administrative expenses of $80,000 and amortization expense of $10,000. In addition, ElectroWizard has a $100,000 loan outstanding at 12%. Its tax rate is 40%. There are 100,000 common shares outstanding.
Prepare an income statement for ElectroWizard in good form (include EPS).

| **ElectroWizard Company<br>Income Statement<br>for the year ended 12/31/_** | | |
|---|---|---|
| Sales (50,000 @ $32) | | $1,600,000 |
| Less: Cost of Goods Sold | | 300,000 |
| Gross Profit | | 1,300,000 |
| Less: Operating Expenses | | |
| Selling and administrative | $80,000 | |
| Amortization | 10,000 | 90,000 |
| Operating Profit (EBIT) | | 1,210,000 |
| Less: Interest expense ($100,000 @ 12%) | 12,000 | |
| Earnings Before Taxes | | 1,198,000 |
| Less: Taxes @ 40% | | 479,200 |
| Net Income | | $718,800 |
| Common Shares | | 100,000 |
| Earnings Per Share | | $7.189 |

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-01 Prepare and analyze the four basic financial statements.*
*Learning Objective: 02-06 Outline the effect of corporate tax considerations on aftertax cash flow.*
*Topic: 02-02 Income Statement*
*Topic: 02-03 Return on Capital*
*Topic: 02-04 Valuation Basics from the Income Statement*
*Topic: 02-21 Effective Tax Rate Examples*



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151. Identify each of the following as increasing (+) or decreasing (-) cash flows from operating activities (O), investment activities (I), or financing activities (F). (EXAMPLE: the sale of plant and equipment would increase cash flows from investing activities, and the correct answer would be + I).
1. Increase in accounts payable
2. Decrease in inventory
3. Net income from operations
4. Payment of common share dividends using ASPE
5. Sale of preferred stock
6. Increase in accrued expenses
7. Purchase of new equipment
8. Decrease in current portion of long term debt
9. Increase in accounts receivable
10. Decrease in notes payable
11. Increase in net worth
12. Increase in long-term liabilities
13. Increase in investments
14. Decrease in marketable securities
15. Reduction in retained earnings
16. Repurchase of common shares outstanding
17. Increase in prepaid expense
18. Decrease in income taxes payable
19. Retirement of long term bonds payable



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20. Sale of new common stock

+O 1. Increase in accounts payable
+O 2. Decrease in inventory
+O 3. Net income from operations
-F 4. Payment of common share dividends using ASPE
+F 5. Sale of preferred stock
-O 6. Increase in accrued expenses
-I 7. Purchase of new equipment
-O 8. Decrease in current portion of long term debt
-O 9. Increase in accounts receivable
-O 10. Decrease in notes payable
+F 11. Increase in net worth
+F 12. Increase in long-term liabilities
-I 13. Increase in investments
+O 14. Decrease in marketable securities
-F 15. Reduction in retained earnings
-F 16. Repurchase of common shares outstanding
-O 17. Increase in prepaid expense
-O 18. Decrease in income taxes payable
-F 19. Retirement of long term bonds payable
+F 20. Sale of new common stock

*Accessibility: Keyboard Navigation*
*Blooms: Apply*
*Difficulty: Medium*
*Learning Objective: 02-04 Explain the importance of cash flows as identified in the statement of cash flows.*
*Topic: 02-12 Determining Cash Flows from Financing Activities*
*Topic: 02-13 Combining the Three Sections of the Statement*
*Topic: 02-14 Amortization and Cash Flow*
*Topic: 02-15 Free Cash Flow*
*Topic: 02-16 Income Tax Considerations*



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