Understanding Balance Sheets & Cash Flow Statements

Test ID: 7659323

Question #1 of 118

Question ID: 414305

Noncurrent assets on the balance sheet are *most* closely linked to which part of the cash flow statement?

✗ **A)** **Operating cash flows.**

✓ **B)** Investing cash flows.

✗ **C)** Financing cash flows.

Explanation

Investing cash flows are most closely linked with a firm's noncurrent assets. For example, purchases and sales of property, plant, and equipment are classified as investing cash flows.

Question #2 of 118

Question ID: 414351

Selected information from the most recent cash flow statement of Thibault Company appears below:

Cash collections	€8,900
Cash paid to suppliers	(€3,700)
Cash operating expenses	(€1,500)
Cash taxes paid	(€2,400)
Cash from operating activities	**€1,300**
Cash paid for plant and equipment	(€2,600)
Cash interest received	€700
Cash dividends received	€600
Cash from investing activities	**(€1,300)**
Cash received from debt issuance	€2,000
Cash interest paid	(€400)
Cash dividends paid	(€600)
Cash from financing activities	**€1,000**
Total change in cash	**€1,000**

Thibault's reinvestment ratio for this period is *closest* to:

✗ **A)** **1.00.**

✓ **B)** 0.50.

✗ **C)** 0.75.

Explanation

The reinvestment ratio is CFO divided by cash paid for long-term assets: 1,300 / 2,600 = 0.5. (Note that on this cash flow statement, CFI includes interest and dividends received and CFF includes interest paid, which is acceptable under IFRS.)

Question #3 of 118

Question ID: 414254

Current assets that arise from the accrual process *most likely* include:

✗ **A)** **marketable securities.**

✓ **B)** accounts receivable.

✗ **C)** cash equivalents.

Explanation

The accrual process refers to accounting for transactions when revenue or expense recognition does not coincide with the exchange of cash. Accounts receivable, for example, represent sales of goods and services that have been recognized as revenue, but for which the firm has not yet been paid cash. Cash equivalents are highly liquid marketable securities, such as Treasury bills, in which a firm typically invests its short-term cash balances.

Question #4 of 118

Question ID: 414330

An analyst has gathered the following information about a company:

Income Statement for the Year 20X4		
Sales		$1,500
Expenses		
COGS	$1,300	
Depreciation	30	
Int. Expenses	40	
Total expenses		1,370
Income from cont. op.		130
Gain on sale		30
Income before tax		160
Income tax		64
Net Income		$96

Additional Information:	
Dividends paid	$30
Common stock sold	20
Equipment purchased	50
Bonds issued	80
Fixed asset sold for (original cost of $100 with accumulated depreciation of $70)	60
Accounts receivable decreased by	30

Inventory decreased by	20
Accounts payable increased by	20
Wages payable decreased by	10

What is the cash flow from operations?

- ✓ **A) $156.**
- ✗ **B)** $150.
- ✗ **C)** $170.

Explanation

Net Income	+$96
Depreciation	+30
Gain on sale of asset	-30
Accts. Rec.	+30
Inventory	+20
Accts. Payable	+20
Wages Payable	-10
CFO	+$156

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Question ID: 414260

The statement of changes in equity is *least likely* to provide information on the firm's:

- ✗ **A) comprehensive income.**
- ✗ **B)** payment of dividends.
- ✓ **C)** repayment of bond principal.

Explanation

The statement of changes in equity shows a firm's comprehensive income (net income and other comprehensive income) and transactions with shareholders, such as dividends paid and issuance or repurchases of stock. Repayment of bond principal is not a change in equity: assets (cash) decrease and liabilities (long-term debt) decrease.

Question #6 of 118

Question ID: 414346

To convert an indirect statement of cash flows to a direct basis, the analyst would:

- ✗ **A) reduce cost of goods sold by any decreases in accounts payable.**
- ✗ **B)** increase cost of goods sold by any depreciation that was included.
- ✓ **C)** reduce cost of goods sold by any decreases in inventory.

Explanation

Decreases in inventory represent a source of cash so these would be subtracted from cost of goods sold. Any depreciation and/or amortization included in the cost of goods sold does not represent an actual use of cash, so this amount should be subtracted from cost of goods sold. Decreases in accounts payable represent a use of cash so these should be added to cost of goods sold.

Question #7 of 118

Question ID: 414315

What is the impact on accounts receivable if sales exceed cash collections and what is the impact on accounts payable if cash paid to suppliers exceeds purchases?

✗ **A) Only accounts payable will increase.**
✓ **B)** Only accounts receivable will increase.
✗ **C)** Both accounts payable and accounts receivable will increase.

Explanation

If a firm sells more than it collects, accounts receivable will increase. If a firm pays suppliers more than it purchases, accounts payable will decrease.

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Question ID: 414244

Do the following characteristics have to be met in order to classify a liability as current on the balance sheet?

Characteristic #1 - Settlement is expected within one year or operating cycle, whichever is less.
Characteristic #2 - Settlement will require the use of cash within one year or operating cycle, whichever is greater.

	Characteristic #1	Characteristic #2
✗ **A)**	**No**	**Yes**
✗ **B)**	Yes	No
✓ **C)**	No	No

Explanation

A current liability is expected to be settled within one year or operating cycle, whichever is *greater*. It is not necessary to settle a current liability with cash. There are a number of ways to settle a current liability. For example, unearned revenue is a liability that is settled by providing goods or services.

Question #9 of 118

Question ID: 434281

Consider the following:

Argument #1: The indirect method presents a firm's operating cash receipts and payments and is thus more consistent with the objectives of the cash flow statement.

Argument #2: The indirect method provides more information than the direct method and is more useful to analysts in estimating future operating cash flows.

Which of these arguments support the use of the indirect method for presenting cash flow from operating activities in the cash flow statement?

✓ **A) Neither argument.**

✗ **B)** Argument #2 only.

✗ **C)** Argument #1 only.

Explanation

It is the *direct* method, not the indirect method, that presents operating cash receipts and payments and is thus more consistent with the objectives of the cash flow statement. The *direct* method provides more information than the indirect method and is preferred by analysts who are estimating future cash flows.

Question #10 of 118

Question ID: 414267

Common size balance sheets express all balance sheet items as a percentage of:

✗ **A) sales.**

✓ **B)** assets.

✗ **C)** equity.

Explanation

Common size balance sheets express all balance sheet items as a percentage of assets. Note that common size income statements express all income statement items as a percentage of sales.

Question #11 of 118

Question ID: 414241

One of a firm's assets is 270-day commercial paper that the firm intends to hold to maturity. One of its liabilities is a short position in a common stock, which the firm holds for trading purposes. How should this asset and this liability be classified on the firm's balance sheet?

✓ **A) Both should be classified as current.**

✗ **B)** Both should be classified as non-current.

✗ **C)** One should be classified as current and one should be classified as non-current.

Explanation

The commercial paper should be classified as current because it will be converted to cash in less than a year. A liability that is held primarily for trading purposes, such as this short position, should also be classified as current.

Question #12 of 118

Question ID: 414298

According to U.S. Generally Accepted Accounting Principles (GAAP) and International Accounting Standards (IAS) GAAP, should dividends paid be treated as a cash flow from financing (CFF) or as a cash flow from operations (CFO)?

	U.S. GAAP	IAS GAAP
✗ A)	**CFF or CFO**	**CFO**
✗ B)	CFO	CFF
✓ C)	CFF	CFF or CFO

Explanation

U.S. GAAP treats dividends paid as CFF whereas IAS GAAP treats dividends paid as either CFO or CFF.

Question #13 of 118

Question ID: 414327

Selected information from Rockway, Inc.'s U.S. GAAP financial statements for the year ended December 31, included the following (in $):

	2004	*2005*
Sales	17,000,000	21,000,000
Cost of Goods Sold	11,000,000	15,000,000
Interest Paid	800,000	1,000,000
Current Income Taxes Paid	700,000	1,000,000
Accounts Receivable	3,000,000	2,500,000
Inventory	2,400,000	3,000,000
Property, Plant & Equip.	2,000,000	16,000,000
Accounts Payable	1,000,000	1,400,000
Long-term Debt	8,000,000	9,000,000
Common Stock	4,000,000	5,000,000

Using the direct method, cash provided or used by operating activities(CFO) in the year 2005 was:

✗ A) **$5,300,000.**

✓ B) $4,300,000.

✗ C) $6,300,000.

Explanation

Cash provided or used by operating activities under the direct method is computed by adding cash inflows and subtracting cash inputs and cash outflows. Operating Cash inflows for Rockway Inc. for 2005 came from sales ($21,000,000) and decrease in accounts receivable ($3,000,000 − $2,500,000 = $500,000) for net cash inflows of ($21,000,000 + $500,000 =) $21,500,000. Operating cash inputs were cost of goods sold ($15,000,000), plus the increase in inventory ($3,000,000 − $2,400,000 = $600,000) less the increase in accounts payable, (which is a source of funds) ($1,000,000 − $1,400,000 = -$400,000) for net cash inputs of ($15,000,000 + $600,000 - $400,000 =) $15,200,000. Other operating cash outflows were interest paid ($1,000,000) and current income taxes paid ($1,000,000) totaling ($2,000,000). Cash provided by operations was ($21,500,000 − $15,200,000 − $2,000,000 =) $4,300,000. Changes in property, plant and equipment, long-term debt and common stock do *not* affect cash from operations.

Question #14 of 118

Question ID: 414276

Which of the following items is NOT found in the financing cash flow part of the statement of cash flows?

✗ **A)** **Dividends paid.**

✗ **B)** Change in long-term debt.

✓ **C)** Change in retained earnings.

Explanation

Changes in retained earnings are not included in the calculation of financing cash flows.

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Question ID: 414274

An examination of the cash receipts and payments of Xavier Corporation reveals the following:

Cash paid to suppliers for purchase of merchandise	$5,000
Cash received from customers	14,000
Cash paid for purchase of equipment	22,000
Dividends paid	2,000
Cash received from issuance of preferred stock	10,000
Interest received on short-term investments	1,000
Wages paid	4,000
Repayment of loan to the bank	5,000
Cash from sale of land	12,000

Under U.S. GAAP, Xavier's reported cash flow from operations will be:

✓ **A)** **$6,000.**

✗ **B)** -$5,000.

✗ **C)** $5,000.

Explanation

Cash flow relating to operating activities includes cash paid to suppliers, cash received from customers, interest received, and wages paid. -5,000 + 14,000 + 1,000 + -4,000 = 6,000.

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Question ID: 414300

Independence, Inc. reports interest received and dividends paid as part of its cash flow from operations. This treatment is acceptable under:

- ✓ **A)** **IFRS but not under U.S. GAAP.**
- ✗ **B)** either IFRS or U.S. GAAP.
- ✗ **C)** U.S. GAAP but not under IFRS.

Explanation

IFRS permits interest received to be reported as either cash flow from operations or cash flow from investing, and permits dividends paid to be reported as either cash flow from operations or cash flow from financing. U.S. GAAP requires interest received to be reported as cash flow from operations, but requires dividends paid to be reported as cash flow from financing.

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Question ID: 414308

Darth Corporation's most recent income statement shows net sales of $6,000, and Darth's marginal tax rate is 40%. The total expenses reported were $3,200, all of which were paid in cash. In addition, depreciation expense was reported at $800. A further examination of the most recent balance sheets reveals that accounts receivable during that period increased by $1,000. The cash flow from operating activities reported by Darth should be:

- ✗ **A)** **$2,200.**
- ✓ **B)** $1,000.
- ✗ **C)** $1,200.

Explanation

Net income is ($6,000 - 3,200 - 800)(1 - 0.4) = $1,200. Adjustments to reconcile net income to cash flow from operating activities will require that depreciation ($800) be added back, and increase in accounts receivable ($1,000) be subtracted: $1,200 + 800 - 1,000 = $1,000.

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Question ID: 414340

Capital Corp.'s activities in the year 20X5 included the following:

- At the beginning of the year, Capital purchased a cargo plane from Aviation Partners for $10 million in exchange for $2 million cash, $3 million in Capital Corp. bonds and $5 million in Capital Corp. preferred stock.
- Interest of $150,000 was paid on the bonds, and dividends of $250,000 were paid on the preferred stock.
- At the end of the year, the cargo plane was sold for $12,000,000 cash to Standard Company. Proceeds from the sale were used to pay off the $3 million in bonds held by Aviation Partners.

On Capital Corp.'s U.S. GAAP statement of cash flows for the year ended December 31, 20X5, cash flow from investments (CFI) related to the above activities is:

- ✗ **A)** **$9,750,000.**
- ✗ **B)** $6,750,000.
- ✓ **C)** $10,000,000.

Explanation

Investing cash of $2 million was used to purchase the cargo plane. Proceeds from the sale of the plane were a source of $12 million of investing cash. Net CFI is $12 million − $2 million = $10 million. Under U.S. GAAP, the interest payment is included in cash from operations (CFO) and the dividend payment in cash from financing (CFF). Redemption of the bonds is a use of cash from financing (CFF).

Question #19 of 118

Question ID: 414237

A key limitation of balance sheets in financial analysis is that:

✓ **A) different balance sheet items may be measured differently.**

✗ **B)** some items are recognized when they are unlikely to reflect a flow of economic benefits.

✗ **C)** liquidity and solvency ratios require information from other financial statements.

Explanation

Balance sheet values may use a mixture of measurement bases (historical cost, fair value, etc.). As a result, balance sheet values of assets, liabilities, and equity may not reflect their intrinsic values. Balance sheets provide the information necessary to calculate the firm's solvency and liquidity ratios. Items are recognized on the balance sheet only if a flow of future economic benefits to or from the firm is probable.

Question #20 of 118

Question ID: 414230

Liabilities are *best* described as:

✓ **A) obligations that are expected to require a future outflow of resources.**

✗ **B)** residual ownership interest.

✗ **C)** resources that are expected to provide future benefits.

Explanation

Liabilities are obligations resulting from past events that are expected to require a future outflow of resources.

Question #21 of 118

Question ID: 414325

Which of the following statements regarding depreciation expense in the cash flow statements is CORRECT? Depreciation is added back to net income when determining CFO using:

✗ **A) the direct method.**

✓ **B)** the indirect method.

✗ **C)** either the direct or indirect methods.

Explanation

Depreciation is a non-cash expense. Only in the indirect method is depreciation added back to net income when determining CFO because net income is only used in the indirect method and not the direct method. The direct method instead starts with cash sales and works down the income statement.

Question #22 of 118

Question ID: 414328

Which of the following statements about the indirect method of calculating the statement of cash flows is NOT correct?

✗ A) **An adjustment is needed for the payment of deferred taxes.**

✓ B) No adjustment is needed to account for changes in accounts receivable since no cash was involved.

✗ C) No adjustment is needed to account for extraordinary items because they are found above net income and are thus already accounted for.

Explanation

Extraordinary items are reported below income from continuing operations but above net income. You must adjust for changes in the working capital accounts: accounts receivable, inventory, and accounts payable.

Question #23 of 118

Question ID: 414283

Which of the following does NOT represent a cash flow relating to operating activity?

✗ A) **Cash received from customers.**

✓ B) Dividends paid to stockholders.

✗ C) Interest paid to bondholders.

Explanation

Dividends paid to stockholders are considered cash flow relating to financing activity. However, U.S. GAAP requires interest paid to bondholders to be considered an operating activity.

Question #24 of 118

Question ID: 414243

Firebird Company reported the following financial information at the end of 2007:

	in millions
Merchandise inventory	$240
Minority interest	70
Cash and equivalents	275
Accounts receivable	1,150
Accounts payable	225
Property & equipment	2,160

Accrued expenses	830
Current portion of long-term debt	120
Long-term debt	1,570
Retained earnings	4,230

Calculate Firebird's current assets and working capital.

	Current assets	Working capital
✓ A)	**$1,665 million**	**$490 million**
✗ B)	$1,735 million	$490 million
✗ C)	$1,665 million	$420 million

Explanation

Current assets are equal to $1,665 ($275 cash and equivalents + $1,150 accounts receivable + $240 inventory). Working capital (current assets minus current liabilities) is equal to $490 ($1,665 current assets - $225 accounts payable - $830 accrued expenses - $120 current portion of long-term debt).

Question #25 of 118

Question ID: 414270

The following data is from Delta's common size financial statement:

Earnings after taxes	18%
Equity	40%
Current assets	60%
Current liabilities	30%
Sales	$300
Total assets	$1,400

What is Delta's total-liabilities-to-equity ratio?

✗ A) **1.0.**

✓ B) 1.5.

✗ C) 2.0.

Explanation

If equity = 40% of assets, total liabilities = 60% of assets, thus 60 / 40 = 1.5.

Question #26 of 118

Question ID: 414287

Which of the following items would *least likely* be included in cash flow from financing?

✗ A) **Dividends paid to shareholders.**

✓ **B)** Gain on sale of stock of a subsidiary.

✗ **C)** Purchase of treasury stock.

Explanation

Gains or losses will be found in cash flow from investments.

Question #27 of 118

Question ID: 414266

Balance sheet data for two comparable firms are presented below:

	Amplus, Inc.	**Brevis, Inc.**
Cash and equivalents	**3,800**	**500**
Accounts receivable	**2,400**	**700**
Inventories	**5,800**	**1,100**
Current assets	**12,000**	**2,300**
Land	**400**	**100**
Property, plant and equipment	**24,600**	**6,400**
Noncurrent assets	**25,000**	**6,500**
Total assets	**37,000**	**8,800**
Accounts payable	**1,800**	**400**
Unearned revenue	**600**	**100**
Current liabilities	**2,400**	**500**
Long-term borrowing	**9,600**	**3,300**
Total liabilities	**12,000**	**3,800**
Common stock	**1,500**	**300**
Retained earnings	**23,500**	**4,700**
Total equity	**25,000**	**5,000**
Total liabilities and equity	**37,000**	**8,800**

Based on common-size analysis of the two firms' balance sheets, Amplus Company:

✓ **A) has a greater investment in working capital than Brevis Company.**

✗ **B)** uses relatively more fixed assets then Brevis Company.

✗ **C)** is more financially leveraged than Brevis Company.

Explanation

Common-size balance sheets for the two firms are as follows:

	Amplus,	**Brevis, Inc.**

	Inc.	
Cash and equivalents	10.3%	5.7%
Accounts receivable	6.5%	8.0%
Inventories	15.7%	12.5%
Current assets	32.4%	26.1%
Land	1.1%	1.1%
Property, plant and equipment	66.5%	72.7%
Noncurrent assets	67.6%	73.9%
Total assets	100.0%	100.0%
Accounts payable	4.9%	4.5%
Unearned revenue	1.6%	1.1%
Current liabilities	6.5%	5.7%
Long-term borrowing	25.9%	37.5%
Total liabilities	32.4%	43.2%
Common stock	4.1%	3.4%
Retained earnings	63.5%	53.4%
Total equity	67.6%	56.8%
Total liabilities and equity	100.0%	100.0%

Working capital (current assets minus current liabilities) is 32.4% - 6.5% = 25.9% of assets for Amplus and 26.1% - 5.7% = 20.4% of assets for Brevis. Fixed assets (property, plant, and equipment) are relatively larger for Brevis than for Amplus. Based on long-term borrowing and total liabilities, Brevis is significantly more leveraged than Amplus.

Question #28 of 118

Question ID: 414295

How would a stock split be reported on the statement of cash flows? A stock split would:

✓ **A) not be reported on the statement of cash flows because it is a non-cash event.**

✗ **B)** be reported as a source of cash in the cash flows from financing.

✗ **C)** be reported as a use of cash in the cash flows from financing.

Explanation

No cash is involved in a stock split--shares are exchanged for shares.

Question #29 of 118

Question ID: 414273

An examination of the cash receipts and payments of Xavier Corporation reveals the following:

Cash paid to suppliers for purchase of merchandise	$5,000
Cash received from customers	14,000

Cash paid for purchase of equipment	22,000
Dividends paid	2,000
Cash received from issuance of preferred stock	10,000
Interest received on short-term investments	1,000
Wages paid	4,000
Repayment of loan to the bank	5,000
Cash from sale of land	12,000

Under U.S. GAAP, Xavier's cash flow from financing (CFF) and cash flow from investing (CFI) will be:

	CFF	CFI
✓ **A)**	**$3,000**	**-$10,000**
✗ **B)**	$3,000	$12,000
✗ **C)**	$10,000	$12,000

Explanation

Cash flow relating to financing activities includes dividends paid, cash received from preferred stock, and repayment of loan. -2,000 + 10,000 + -5,000 = 3,000.

Cash flow relating to investing activities includes cash paid for equipment and cash from sale of land. -22,000 + 12,000 = -10,000.

Question #30 of 118

Question ID: 414238

A liquidity-based balance sheet, on which assets and liabilities are not classified as current or non-current, is permitted under:

✓ **A) IFRS only.**
✗ **B)** U.S. GAAP only.
✗ **C)** Both IFRS and U.S. GAAP.

Explanation

Liquidity-based balance sheet presentation is an exception, under IFRS only, to the requirement (under both IFRS and U.S. GAAP) for assets and liabilities to be classified as current or non-current. Under IFRS, a firm may present a liquidity-based balance sheet if this format is more reliable and relevant than a classified balance sheet.

Question #31 of 118

Question ID: 414275

Jodi Lein, small business consultant, is currently working with RJ Landscaping, a sole proprietorship. She is trying to educate the owner on the importance of monitoring cash flows. Operating information as of the end of the most recent month appears below:

- Cash from sale of truck of $7,000.
- Cash salaries paid of $17,000.
- Cash from customers of $45,000.
- Depreciation expense of $5,500.
- Interest on bank line of credit of $1,000.
- Cash paid to suppliers of $22,000.
- Other cash expenses, including rent, of $6,300.
- No taxes due.

Using this information and U.S. GAAP, what is the cash flow from operations for the month?

✗ **A)** **$11,200.**

✓ **B)** -$1,300.

✗ **C)** -$300.

Explanation

The format of the question information suggests the use of the *direct* cash flow method. In this method, depreciation is *not* a component of cash flow from operations. Cash flow from operations = (all numbers in thousands of dollars) 45 - 17 - 22 - 6.3 - 1.0 = -1.3, or -$1,300.

Question #32 of 118

Question ID: 414344

In converting a statement of cash flows from the indirect to the direct method, which of the following adjustments should be made for a decrease in unearned revenue when calculating cash collected from customers, and for an inventory writedown (when market value is less than cost) when calculating cash payments to suppliers?

	Cash collections from customers:	Cash payments to suppliers:
✗ **A)**	**Subtract decrease in unearned revenue**	**Add an inventory writedown**
✗ **B)**	Add decrease in unearned revenue	Subtract an inventory writedown
✓ **C)**	Subtract decrease in unearned revenue	Subtract an inventory writedown

Explanation

Beginning with net sales, calculating cash collected from customers requires the addition (subtraction) of any increase (decrease) in unearned revenue. Cash advances from customers represent unearned revenue and are not included in net sales, so any advances must be added to net sales in order to calculate cash collected.

An inventory writedown, as a result of applying the lower of cost or market rule, will reduce ending inventory and increase COGS for the period. However, no cash flow is associated with the writedown, so COGS is reduced by the amount of the writedown in calculating cash paid to suppliers.

Question #33 of 118

Question ID: 414332

An analyst has gathered the following information about a company:

Income Statement for the Year 20X5

Sales		$1,500
Expenses		
COGS	$1,300	
Depreciation	20	
Goodwill	10	
Int. Expenses	40	
Total expenses		1,370
Income from cont. op.		130
Gain on sale		30
Income before tax		160
Income tax		64
Net Income		$96

Additional Information:	
Dividends paid	30
Common stock sold	20
Equipment purchased	50
Bonds issued	80
Fixed asset sold for (original cost of $100 with accumulated depreciation of $70)	60
Accounts receivable decreased by	30
Inventory decreased by	20
Accounts payable increased by	20
Wages payable decreased by	10

What is the cash flow from investing?

✗ **A) $130.**

✓ **B)** $10.

✗ **C)** $110.

Explanation

Purchase of equipment	-$50
Fixed asset sold	$60
CFI	$10

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Question ID: 414280

Holden Company's fixed asset footnote included the following:

- During 20X7, Holden sold machinery for a gain of $100,000. The machinery had an original cost of $500,000 and its

accumulated depreciation was $240,000.
- At the end of 20X7, Holden purchased machinery at a cost of $1,000,000. Holden paid $400,000 cash. The balance was financed by the seller at 8% interest.
- Depreciation expense was $2,080,000 for the year ended 20X7.

Calculate Holden's cash flow from investing activities for the year ended 20X7.

✗ **A) $360,000 inflow.**

✓ **B)** $40,000 outflow.

✗ **C)** $300,000 outflow.

Explanation

Given the gain of $100,000 and book value of the machinery sold of $260,000 ($500,000 original cost - $240,000 accumulated depreciation), the proceeds from the sale of the machinery were $360,000 ($100,000 gain + $260,000 book value). For 20X7, CFI was an outflow of $40,000 ($360,000 sale proceeds - $400,000 machinery purchase). The $600,000 financed by the seller is a non-cash transaction and is reported in the notes to the cash flow statement.

Question #35 of 118

Question ID: 414255

Earlier this year, Slayton Corporation repurchased 5% of its total shares outstanding. At the time, the book value of Slayton shares exceeded their market value. The shares are expected to be reissued in the future when the market price of Slayton's stock increases. Do Slayton's repurchased shares continue to have voting rights and to pay cash dividends?

	Voting rights	Cash dividends paid
✗ **A)**	**Yes**	**No**
✗ **B)**	No	Yes
✓ **C)**	No	No

Explanation

Repurchased stock that is not cancelled is called treasury stock. Treasury stock does not have voting rights and does not receive cash dividends.

Question #36 of 118

Question ID: 414310

The following information is from the balance sheet of Silverstone Company:

Net Income for 5/1/20X5 to 5/31/20X5: $8,000

Balance 5/01/20X5	Account	Balance 5/31/20X5
$2,000	Inventory	$1,750
$1,200	Prepaid exp.	$1,700
$800	Accum. Depr.	$975

$425	Accounts payable	$625
$650	Bonds payable	$550

Using the indirect method, calculate the cash flow from operations for Silverstone Company as of 5/31/20X5:

✗ **A) Increase in cash of $7,725.**
✓ **B)** Increase in cash of $8,125.
✗ **C)** Increase in cash of $8,025.

Explanation

Silverstone Company's cash flow from operations would be calculated as +Net Income $8,000 + Inventory $250 - Prepaid exp. $500 + Depreciation $175 + A/P $200 = $8,125.

Bonds payable is a financing activity and would not be included in the cash flow from operations. The indirect method takes the change in the non-cash accounts and decreases or increases net income to get to the change in cash flow.

Question #37 of 118

Question ID: 414347

The only section of the statement of cash flows that must be adjusted to convert a statement of cash flows from the indirect to the direct method is:

✓ **A) cash flows from operations.**
✗ **B)** cash flows from financing.
✗ **C)** cash flows from investing.

Explanation

The cash flows from investing activities and cash flows from financing activities sections of the statement of cash flows are the same for both the indirect and direct methods. Only the cash flows from operations section must be adjusted to convert the statement of cash flows from the indirect to the direct method.

Question #38 of 118

Question ID: 414317

Pacific, Inc.'s financial information includes the following, with "change" referring to the difference from the prior year (in $ millions):

Net Income	27
Change in Accounts Receivable	+4
Change in Accounts Payable	+1
Change in Inventory	+5
Loss on sale of equipment	-8
Gain on sale of real estate	+4
Change in Retained Earnings	+21

> Dividends declared and paid +4

Pacific, Inc.'s cash flow from operations (CFO) in millions was:

- ✗ **A)** **$15.**
- ✓ **B)** $23.
- ✗ **C)** $27.

Explanation

Using the indirect method, cash flow from operations is net income less increase in accounts receivable, plus increase in accounts payable, less increase in inventory, plus loss on sale of equipment, less gain on sale of real estate. 27 - 4 + 1 - 5 + 8 - 4 = $23 million.

Question #39 of 118

Question ID: 414303

The difference between cash flow from operations (CFO) under the direct method and CFO under the indirect method is:

- ✓ **A)** **always equal to zero.**
- ✗ **B)** disclosed as a reserve in the footnotes to the cash flow statement.
- ✗ **C)** balanced by an opposite difference in cash flow from investing.

Explanation

The direct and indirect methods are two ways of presenting the same total for cash from operations.

Question #40 of 118

Question ID: 414350

Which of the following *best* describes a ratio that measures a firm's ability to acquire long-term assets with cash flows from operations, and a performance ratio, respectively?

	Acquire assets with CFO	Performance ratio
✗ **A)**	**Reinvestment ratio**	**Debt payment ratio**
✓ **B)**	Reinvestment ratio	Cash-to-income ratio
✗ **C)**	Investing and financing ratio	Cash-to-income ratio

Explanation

The reinvestment ratio measures a firm's ability to acquire long-term assets with cash flows from operations. In contrast, the investing and financing ratio, which is more comprehensive, measures the firm's ability to purchase assets, satisfy debts, and pay dividends.

The cash-to-income ratio measures the ability to generate cash from a firm's operations and is a performance ratio for cash flow analysis purposes. The debt payment ratio measures the firm's ability to satisfy long-term debt with cash flow from operations but it is more of a coverage ratio than a performance ratio.

Question #41 of 118

Question ID: 414268

An analyst has gathered the following information about a company:

Balance Sheet	
Assets	
Cash	100
Accounts Receivable	750
Marketable Securities	300
Inventory	850
Property, Plant & Equip	900
Accumulated Depreciation	(150)
Total Assets	2750
Liabilities and Equity	
Accounts Payable	300
Short-Term Debt	130
Long-Term Debt	700
Common Stock	1000
Retained Earnings	620
Total Liab. and Stockholder's equity	2750
Income Statement	
Sales	1500
COGS	1100
Gross Profit	400
SG&A	150
Operating Profit	250
Interest Expense	25
Taxes	75
Net Income	150

What is the quick ratio?

- ✗ **A)** **1.53.**
- ✓ **B)** 2.67.
- ✗ **C)** 0.62.

Explanation

Quick ratio = [100(cash) + 750(AR) + 300(marketable securities)] / [300(AP) + 130(short-term debt)] = (1,150 / 430) = 2.67

Question #42 of 118

Question ID: 414309

Convenience Travel Corp.'s financial information for the year ended December 31, 20X4 included the following:

Property Plant & Equipment	$15,000,000
Accumulated Depreciation	9,000,000

The only asset owned by Convenience Travel in 20X5 was a corporate jet airplane. The airplane was being depreciated over a 15-year period on a straight-line basis at a rate of $1,000,000 per year. On December 31, 20X5 Convenience Travel sold the airplane for $10,000,000 cash. Net income for the year ended December 31, 20X5 was $12,000,000. Based on the above information, and ignoring taxes, what is cash flow from operations (CFO) for Convenience Travel for the year ended December 31, 20X5?

✗ **A)** **$13,000,000.**

✗ **B)** $11,000,000.

✓ **C)** $8,000,000.

Explanation

Using the indirect method, CFO is net income increased by 20X5 depreciation ($1,000,000) and decreased by the gain recognized on the sale of the plane [$10,000,000 sale price − ($15,000,000 original cost − $10,000,000 accumulated depreciation including 20X5) = $5,000,000]. $12,000,000 + $1,000,000 − $5,000,000 = $8,000,000.

Question #43 of 118

Question ID: 414252

On January 1, 20X7, Omega Corporation paid $45,000 to renew its property insurance for 3 years. What amount of insurance expense should Omega report for the year-ended December 31, 20X7 and what is the balance of Omega's prepaid insurance account on December 31, 20X8?

	Insurance expense	Prepaid insurance
✗ **A)**	**$15,000**	**$30,000**
✗ **B)**	$45,000	$15,000
✓ **C)**	$15,000	$15,000

Explanation

At the beginning of 20X7, the prepaid insurance account (asset) will have a balance of $45,000. Insurance expense will be recognized at a rate of $15,000 per year. At the end of 20X8, one year's insurance remains; thus, the balance of the prepaid insurance account will equal $15,000 ($45,000 beginning balance - $15,000 insurance expense for 20X7 - $15,000 insurance expense for 20X8).

Question #44 of 118

Question ID: 414282

Interest payments, either as part of a coupon payment or to creditors, are considered which type of cash flow under U.S.

GAAP?

- ✓ **A) Operating.**
- ✗ **B)** Investing.
- ✗ **C)** Financing.

Explanation

Under U.S. GAAP, interest paid is an operating cash flow.

Question #45 of 118

Question ID: 434282

Consider the following:

Statement #1: One approach to presenting a common-size cash flow statement is to express each inflow of cash as a percentage of total cash inflows and each outflow of cash as a percentage of total cash outflows.

Statement #2: Expressing each line item of the cash flow statement as a percentage of revenue is useful in forecasting future cash flows.

Which of these statements regarding a common-size cash flow statement is (are) CORRECT?

- ✗ **A) Only statement #1 is correct.**
- ✗ **B)** Only statement #2 is correct.
- ✓ **C)** Both statements are correct.

Explanation

A cash flow statement can be presented in common-size format by expressing each line item as a percentage of total revenue or by expressing each inflow of cash as a percentage of total cash inflows and each outflow as a percentage of total cash outflows. Expressing each line item of the cash flow statement as a percentage of revenue is useful in forecasting future cash flows since revenue usually drives the forecast.

Question #46 of 118

Question ID: 414286

Which of the following is NOT a category on the statement of cash flows? Cash flow from:

- ✗ **A) financing.**
- ✗ **B)** operations.
- ✓ **C)** sales.

Explanation

There are only three types of cash flows: financing, investing, and operating.

Question #47 of 118

Question ID: 414279

Which of the following would NOT be a component of cash flow from investing?

✗ **A)** **Purchase of equipment.**

✗ **B)** Sale of land.

✓ **C)** Dividends paid.

Explanation

Dividends paid is not a component of cash flow from investing, it is a component of cash flow from financing. The other items are all components of cash flow from investing.

Question #48 of 118

Question ID: 414285

Which of the following items would NOT be included in cash flow from investing?

✓ **A)** **Selling stock of the company.**

✗ **B)** Proceeds related to acquisitions.

✗ **C)** Buying or selling a building.

Explanation

Selling stock of the company would be a financing cash flow.

Question #49 of 118

Question ID: 414321

Which of the following statements about accounting procedures and their impact on the statement of cash flows is *least valid*? All else equal:

✓ **A)** **A nonprofitable company that uses LIFO to account for inventory will have higher total cash flow than a nonprofitable company that uses FIFO during a period of rising prices.**

✗ **B)** Cash flow from financing (CFF) is higher over the life of a bond if a firm issues the bond at a premium, compared to issuing the bond at par.

✗ **C)** A company that finances through common stock issues may have the same cash flow from financing (CFF) as a firm that issues debt.

Explanation

Because of the impact of income taxes, a *profitable* company that accounts for inventory using LIFO will have higher total cash flow than a *profitable* company that uses FIFO. The company that uses LIFO will have higher cost of goods sold, resulting in lower net income and thus lower taxes.

The other statements are accurate:

- A company that issues common stock is *not* required to pay dividends (which would reduce cash flow from financing). Thus, it may have the same CFF as a firm that issues debt since interest paid on debt is a component of CFO.
- When a company issues bonds at a premium, the proceeds raised at issuance (CFF inflow) are greater than the par value

repaid at maturity (CFF outflow). For bonds issued at par, the CFF inflow at issuance is equal to the CFF outflow at maturity.

Question #50 of 118

Question ID: 414343

Maverick Company reported the following financial information for 2007:

	in millions
Beginning accounts receivable	$180
Ending accounts receivable	225
Sales	11,000
Beginning inventory	2,000
Ending inventory	2,300
Purchases	8,100
Beginning accounts payable	1,600
Ending accounts payable	1,200

Calculate Maverick's cost of goods sold and cash paid to suppliers for 2007.

	Cost of goods sold	Cash paid to suppliers
✓ **A)**	**$7,800 million**	**$8,500 million**
✗ **B)**	$7,800 million	$7,100 million
✗ **C)**	$3,800 million	$8,500 million

Explanation

Cost of goods sold is equal to $7,800 million ($2,000 million beginning inventory + $8,100 million purchases - $2,300 million ending inventory). Cash paid to suppliers is equal to $8,500 million (-$7,800 COGS - $300 million increase in inventory - $400 million decrease in accounts payable). Alternate solution: Cash paid to suppliers is equal to $8,500 million (-$8,100 million purchases - $400 decrease in accounts payable).

Question #51 of 118

Question ID: 414290

When a U.S. company pays dividends to its stockholders, which type of cash flow does this represent?

✗ **A)** **Operating.**

✓ **B)** Financing.

✗ **C)** Investing.

Explanation

Dividends paid to stockholders are considered cash outlays from financing according to U.S. GAAP.

Question #52 of 118

Question ID: 414320

A company has the following changes in its balance sheet accounts:

Net Sales	$500
An increase in accounts receivable	20
A decrease in accounts payable	40
An increase in inventory	30
Sale of common stock	100
Repayment of debt	10
Depreciation	2
Net Income	100
Interest expense on debt	5

The company's cash flow from financing is:

✗ **A)** **$100.**

✓ **B)** $90.

✗ **C)** -$10.

Explanation

Sale of common stock	$100
Repayment of debt	(10)
Financing cash flows	$ 90

Question #53 of 118

Question ID: 414249

According to the Financial Accounting Standards Board, what is the appropriate measurement basis for equipment used in the manufacturing process and inventory that is held for sale?

	Equipment	Inventory
✗ **A)**	**Historical cost**	**Historical cost**
✗ **B)**	Fair value	Lower of cost or market
✓ **C)**	Historical cost	Lower of cost or market

Explanation

Equipment is reported in the balance sheet at historical cost less accumulated depreciation. Inventory is reported in the balance sheet at the lower of cost or market.

Question #54 of 118

Question ID: 414341

Favor, Inc.'s capital and related transactions during 20X5 were as follows:

- On January 1, $1,000,000 of 5-year 10% annual interest bonds were issued to Cover Industries in exchange for old equipment owned by Cover.
- On June 30, Favor paid $50,000 of interest to Cover.
- On July 1, Cover returned the bonds to Favor in exchange for $1,500,000 par value 6% preferred stock.
- On December 31, Favor paid preferred stock dividends of $45,000 to Cover.

Favor, Inc.'s cash flow from financing (CFF) for 20X5 (assume U.S. GAAP) is:

✓ **A)** **−$45,000.**

✗ **B)** −$1,045,000.

✗ **C)** −$95,000.

Explanation

Only the preferred stock dividends paid would be considered CFF. Issuing bonds in exchange for equipment and exchanging bonds for stock are both noncash transactions that should be disclosed in a footnote to the Statement of Cash Flows. Interest paid is an operating cash flow under U.S. GAAP.

Question #55 of 118

Question ID: 414236

The balance sheet is *most likely* to provide an analyst with information about a firm's:

✗ **A)** **operating profitability.**

✓ **B)** solvency.

✗ **C)** internal controls.

Explanation

An analyst can use the balance sheet to assess a firm's solvency and liquidity. Operating profitability can be assessed by examining the income statement. Information on a firm's internal controls appears in management's commentary and the auditor's report.

Question #56 of 118

Question ID: 414307

Use the following financial data for Moose Printing Corporation to calculate the cash flow from operations (CFO) using the indirect method.

- Net income: $225

- Increase in accounts receivable: $55
- Decrease in inventory: $33
- Depreciation: $65
- Decrease in accounts payable: $25
- Increase in wages payable: $15
- Decrease in deferred taxes: $10
- Purchase of new equipment: $65
- Dividends paid: $75

✗ **A) Increase in cash of $173.**

✓ **B)** Increase in cash of $248.

✗ **C)** Increase in cash of $183.

Explanation

CFO for Moose Printing Corporation is calculated as follows:

+Net Income $225 − A/R $55 + Inventory $33 + Depreciation $65 − A/P $25 + Wages Payable $15 − Deferred taxes $10 = $248.

The purchase of new equipment would be an investing activity and, therefore, would not be included in the CFO. Dividends paid would be a financing activity and would not be included in the CFO.

Question #57 of 118

Question ID: 414345

To convert an indirect statement of cash flows to a direct basis, the analyst would:

✓ **A) add decreases in accounts receivables to net sales.**

✗ **B)** subtract increases in inventory from cost of goods sold.

✗ **C)** add increases in accounts payable to cost of goods sold.

Explanation

A decrease in accounts receivable represents an increase in cash so this should be added to sales. Increases in accounts payable represent an increase in cash so these should be subtracted from cost of goods sold. Increases in inventory represent a use of cash so these would be added to cost of goods sold.

Question #58 of 118

Question ID: 414337

A firm has net sales of $3,500, earnings after taxes (EAT) of $1,000, depreciation expense of $500, cost of goods sold (COGS) of $1,500, and cash taxes of $500. Also, inventory decreased by $100, and accounts receivable increased by $300. What is the firm's cash flow from operations?

✗ **A) $1,200.**

✗ **B)** $1,800.

✓ **C)** $1,300.

Explanation

Indirect Method	
EAT	+1,000
Depreciation	+500
Change in Inv.	+ 100 a source
Change in Accts. Rec.	(300) a use
CFO	**1,300**

Direct Method	
Net Sales	+3,500
Change in Accts. Rec.	(300) a use
COGS	(1,500)
Cash Taxes	(500)
Change in Inv.	+100 a source
CFO	**1,300**

Question #59 of 118

Question ID: 414299

The CORRECT set of cash flow treatments as they relate to interest and dividends received according to U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) is:

	U.S. GAAP	IFRS
✗ A)	**CFI or CFO**	**CFI**
✗ B)	CFI	CFO
✓ C)	CFO	CFI or CFO

Explanation

U.S. GAAP treats interest and dividends received as CFO whereas under IFRS interest and dividends received may be treated as either CFO or CFI.

Question #60 of 118

Question ID: 414239

Liquidity-based presentation of a balance sheet is *most likely* to be used by a:

✗ **A) manufacturer.**

✓ **B)** bank.

✗ **C)** retailer.

Explanation

The liquidity-based format of balance sheet presentation is most common in the banking industry.

Question #61 of 118

Peterson Painting Company is a commercial painting contractor. At the beginning of 20X7, Peterson's net working capital was $350,000. The following transactions occurred during 20X7:

Performed services on credit	$150,000
Purchased office equipment for cash	10,000
Recognized salaries expense	54,000
Purchased paint supplies on on credit	25,000
Consumed paint supplies	20,000
Paid salaries	50,000
Collected accounts receivable	157,000
Recognized straight-line depreciation expense	2,000
Paid accounts payable	15,000

Calculate Peterson's working capital at the end of 20X7 and the change in cash for the year 20X7.

	Working capital	Change in cash
✗ A)	**$416,000**	**$80,000**
✓ B)	$416,000	$82,000
✗ C)	$414,000	$82,000

Explanation

Transaction	Amount	Working capital	Cash
Performed services on credit	$150,000	Increase A/R	
Purchased PP&E for cash	10,000	Decrease cash	-$10,000
Recognized salaries expense	54,000	Increase A/P	
Purchased paint supplies on on credit	25,000	Increase inventories, increase A/P	
Consumed paint supplies	20,000	Decrease inventories	
Paid salaries	50,000	Decrease cash, decrease A/P	-$50,000
Collected accounts receivable	157,000	Increase cash, decrease A/R	+$157,000
Recognized straight-line depreciation expense	2,000		
Paid accounts payable	15,000	Decrease cash, decrease A/P	-$15,000

The change in cash was $82,000 ($157,000 collections - $10,000 from equipment purchase - $50,000 salaries paid - $15,000 for payables).

Working capital at the end of 20X7 is $416,000 ($350,000 beginning working capital + $150,000 increase in accounts receivable from services - $10,000 office equipment purchase - $54,000 salaries expense accrual - $20,000 consumed supplies).

- Purchasing $25,000 of paint supplies on credit has no net effect on working capital (current assets and current liabilities increase). Consuming $20,000 of these supplies reduces working capital (current assets decrease).
- Salary expense reduces working capital by $54,000 when recognized (current liabilities increase). Paying $50,000 of these salaries has no net effect on working capital (current assets and current liabilities decrease).
- Collecting accounts receivable has no net effect on working capital (one current asset increases and another decreases).
- Recognizing depreciation does not affect working capital.
- Paying accounts payable has no net effect on working capital (current assets and current liabilities decrease).

Question #62 of 118

Question ID: 414306

Use the following information to calculate cash flows from operations using the indirect method.

- Net Income: $12,000
- Depreciation Expense: $1,000
- Loss on sale of machinery: $500
- Increase in Accounts Receivable: $2,000
- Decrease in Accounts Payable: $1,500
- Increase in Income taxes payable: $500
- Repayment of Bonds: $3,000

✗ **A) Increase in cash of $7,500.**

✗ **B)** Increase in cash of $9,500.

✓ **C)** Increase in cash of $10,500.

Explanation

Cash flow from operations would be calculated as +Net Income $12,000 + Depreciation $1,000 + Loss on sale of machinery $500 − A/R $2,000 − A/P $1,500 + Income taxes payable $500 = $10,500.

Repayment of Bonds is a financing activity and would not be included with operating activities. Depreciation is not a cash flow activity and is therefore always added back to net income to calculate CFO. The loss on the sale of machinery is not a cash outflow so it is also added back to calculate CFO. Accounts receivable is subtracted when there is an increase as this increases net income but does not affect cash.

Question #63 of 118

Question ID: 414338

An analyst has gathered the following information about a company that reports under U.S. GAAP:

Income Statement for the Year

Sales		$1,500
Expenses		
COGS	$1,300	
Depreciation	20	
Goodwill	10	
Int. Expenses	40	
Total expenses		1,370

Income from cont. op.	130
Gain on sale	30
Income before tax	160
Income tax	64
Net Income	$96

Additional Information:	
Dividends paid	$30
Common stock issued	20
Equipment purchased	50
Bonds issued	80
Fixed asset sold for (original cost of $100 with accumulated depreciation of $70)	60
Accounts receivable decreased by	30
Inventory decreased by	20
Accounts payable increased by	20
Wages payable decreased by	10

What is the cash flow from financing?

- ✗ **A) $130.**
- ✗ **B)** $110.
- ✓ **C)** $70.

Explanation

Dividends paid	-$30
Stock issued	20
Bonds issued	80
CFF	$70

Question #64 of 118

Question ID: 414235

Duster Company reported the following financial information at the end of 2007:

	in millions
Unearned revenue	$240
Common stock at par	30
Capital in excess of par	440
Accounts payable	1,150
Treasury stock	2,000
Retained earnings	5,160
Accrued expenses	830
Accumulated other comprehensive loss	210

Long-term debt	1,570

Calculate Duster's liabilities and stockholders' equity as of December 31, 2007.

	Liabilities	Stockholders' equity
✓ A)	**$3,790 million**	**$3,420 million**
✗ B)	$3,790 million	$7,420 million
✗ C)	$3,550 million	$7,840 million

Explanation

Liabilities are equal to $3,790 million ($240 million unearned revenue + $1,570 long-term debt + $1,150 accounts payable + $830 accrued expenses). Stockholders' equity is equal to $3,420 million ($30 common stock at par + $440 capital in excess of par - $2,000 treasury stock + $5,160 retained earnings - $210 accumulated other comprehensive loss).

Question #65 of 118

Question ID: 414333

An analyst contemplates using the indirect method to create the projected statement of cash flows. She decides to research the differences between the direct and indirect methods. Which of the following is *least likely* a component of the statement of cash flows under the direct method?

✗ A) **Payment of dividends.**

✗ B) Property, Plant, & Equipment.

✓ C) Net income.

Explanation

Property, Plant, & Equipment and payment of dividends are components of the statement of cash flows under both the direct and indirect methods. Net income is the first figure under the indirect method, but it is not a part of the statement of cash flows under the direct method. The correct response is net income.

Question #66 of 118

Question ID: 414336

Determine the cash flow from financing given the following table.

Item	*Amount*
Cash payment of dividends	$30
Sale of equipment	$10
Net income	$25
Purchase of land	$15
Increase in accounts payable	$20
Sale of preferred stock	$25
Increase in deferred taxes	$5

Profit on sale of equipment $15

- ✗ **A) $15.**
- ✓ **B)** -$5.
- ✗ **C)** $20.

Explanation

CFF = 25(Sale of Stock) − 30(Div Paid) = -$5

Question #67 of 118

Question ID: 414331

The Beeline Company has the following balance sheet and income statement.

Beeline Company Balance Sheet

As of December 31, 20X4

	2003	*2004*		*2003*	*2004*
Cash	$50	$60	Accounts payable	$100	$150
Accounts receivable	100	110	Long-term debt	400	300
Inventory	200	180	Common stock	50	50
			Retained earnings	400	500
Fixed assets (gross)	800	900	Total liabilities and equity	$950	$1,000
Less: Accumulated depreciation	200	250			
Fixed assets (net)	600	650			
Total assets	$950	$1,000			

Beeline Company Income Statement

For year ended December 31, 20X4

Sales	$1,000
Less:	
COGS	600
Depreciation	50
Selling, general, and administrative expenses	160
Interest expense	23
Income before taxes	$167
Less tax	67
Net income	$100

The cash flow from operations for 2004 is:

✗ **A) $260.**

✓ **B)** $210.

✗ **C)** $150.

Explanation

Cash flow from operations (CFO) calculated using the indirect method is: net income (100) + depreciation (50) - increase in accounts receivable (10) + decrease in inventory (20) + increase in accounts payable (50) = $210.

Question #68 of 118

Question ID: 414329

Which of the following is CORRECT about the consideration of depreciation in the operations section of a cash flow statement?

	Direct Method	Indirect Method
✗ **A)**	**Does not consider**	**Does not consider**
✗ **B)**	Considers	Considers
✓ **C)**	Does not consider	Considers

Explanation

The indirect method must add back depreciation expense because the starting point is net income. Since the direct method does not begin with net income it does not need to consider non-cash expenses such as depreciation.

Question #69 of 118

Question ID: 414256

Ascot Corporation has 4 million shares of common stock authorized, 2.4 million shares of common stock issued, and 1.8 million shares of common stock outstanding. How many shares of treasury stock does Ascot own and is the treasury stock reported as an asset in Ascot's balance sheet?

	Treasury shares	Reported as an asset
✗ **A)**	**1.6 million**	**No**
✗ **B)**	600,000	Yes
✓ **C)**	600,000	No

Explanation

Shares that were issued previously but are not outstanding are treasury shares (owned by the firm). Thus, there are 600,000 treasury shares (2.4 million issued - 1.8 million outstanding). Treasury shares are reported as a reduction in shareholders' equity on the balance sheet. Treasury stock is not an asset.

Question #70 of 118

Question ID: 414284

Which of the following is *least likely* a cash flow in the calculation of cash flow from operations under U.S. GAAP?

✗ **A)** **Interest paid.**

✗ **B)** Dividends received.

✓ **C)** Dividends paid.

Explanation

According to SFAS 95, dividends paid are treated as cash flow from financing.

Question #71 of 118

Question ID: 414291

If Jackson Ski Company issues common stock, and uses the proceeds to purchase fixed assets such as equipment:

✗ **A)** **cash flow from financing would decrease and cash flow from investing would increase.**

✗ **B)** both cash flow from operations and cash flow from financing would increase.

✓ **C)** cash flow from financing would increase and cash flow from investing would decrease.

Explanation

Cash flow from financing increases when stock is issued, while cash flow from investing decreases when spending for purchases of fixed assets.

Question #72 of 118

Question ID: 414294

Which of the following transactions would *least likely* be reported in the cash flow statement as investing cash flows?

✓ **A)** **Purchase of plant and equipment used in the manufacturing process with financing provided by the seller.**

✗ **B)** Sale of held-to-maturity securities for cash.

✗ **C)** Principal payments received from loans made to others.

Explanation

The purchase of plant and equipment with financing provided by the seller is a non-cash transaction. Non-cash transactions are disclosed separately in a note or supplementary schedule to the cash flow statement.

Question #73 of 118

Question ID: 414335

Determine the cash flow from operations given the following table.

Item	*Amount*

Cash payment of dividends	$30
Sale of equipment	$25
Net income	$25
Purchase of land	$15
Increase in accounts payable	$20
Sale of preferred stock	$25
Increase in deferred taxes	$5
Profit on sale of equipment	$15

✓ **A) $35.**

✗ **B)** $45.

✗ **C)** $20.

Explanation

Using the indirect method, CFO = Net income 25 + increase in accounts payable 20 + increase in deferred taxes 5 − profit on sale of equipment 15 = $35.

Increases in accounts payable and deferred taxes are sources of operating cash that are not included in net income and must be added. Profit on sale of equipment is a CFI item that must be removed from net income.

No adjustment needs to be made for cash payment of dividends (CFF), sale of preferred stock (CFF), or purchase of land (CFI) because they are not included in net income. Only the profit on sale of equipment, not the full proceeds from sale, is included in net income.

Question #74 of 118

Question ID: 414257

Carpenter Corporation reported the following statement of shareholders' equity as of December 31, 2006:

Common stock at par	$600,000
Additional paid-in-capital	900,000
Treasury stock	(200,000)
Retained earnings	10,500,000
Accumulated other comprehensive income	450,000
	$12,250,000

During 2007, Carpenter:

- earned net income of $1,700,000.
- declared dividends of $300,000. $75,000 of the dividends remain unpaid.
- purchased held-to-maturity securities for $100,000. The securities have a fair value of $110,000 at year-end.
- purchased available-for-sale securities for $250,000. The securities have a fair value of $225,000 at year-end.
- translated the financial statements of a foreign subsidiary and calculated a $90,000 unrealized gain.
- purchased treasury stock for $75,000. The stock was valued at $60,000 when issued.

Calculate Carpenter's retained earnings and accumulated other comprehensive income as of December 31, 2007.

	Retained earnings	Accumulated other comprehensive income
✗ A)	**$12,125,000**	**$515,000**
✓ B)	$11,900,000	$515,000
✗ C)	$11,900,000	$65,000

Explanation

As of December 31, 2007, Carpenter's retained earnings is $11,900,000 [$10,500,000 beginning balance + $1,700,000 net income - $300,000 dividends declared]. Accumulated other comprehensive income is $515,000 [$450,000 beginning balance - $25,000 unrealized loss from available for sale securities ($225,000 fair value - $250,000 cost) + $90,000 unrealized translation gain]. There is no impact on retained earnings or accumulated other comprehensive income from unrealized gains and losses on held-to-maturity securities since the securities are not reported at fair value on the balance sheet. The purchase of treasury stock does not affect comprehensive income because it is a transaction with shareholders.

Question #75 of 118

Question ID: 414234

Galaxy Corporation manufactures custom motorcycles. Galaxy finances the motorcycles over 36 months for customers who make a minimum down payment of 10%. Historically, Galaxy has experienced bad debt losses equal to 1% of sales. Galaxy also provides a 24 month unlimited warranty on all new motorcycles. In the past, warranty expense has averaged 3% of sales. Ignoring taxes, how does the recognition of bad debt expense and warranty expense at the time of sale affect Galaxy's liabilities?

	Bad debt expense	Warranty expense
✗ A)	**Increase**	**Increase**
✗ B)	No effect	No effect
✓ C)	No effect	Increase

Explanation

The recognition of bad debt expense has no effect on liabilities, current revenues are reduced by the expected amount of uncollectable accounts. Bad debt expense reduces net income and reduces assets. The recognition of expected warranty expense decreases net income (following the matching principle), and since it is not currently paid (doesn't reduce assets) it creates or increases a liability at the time of sale.

Question #76 of 118

Question ID: 414316

Murray Company reported the following revenues and expenses for the year ended 2007:

Sales revenue	$200,000
Wage expense	89,000

Insurance expense	17,000
Interest expense	10,400
Depreciation expense	50,000

Following are the related balance sheet accounts:

	2007	2006
Unearned revenue	$15,600	$13,200
Wages payable	5,400	6,600
Prepaid insurance	1,200	0
Interest payable	500	1,600
Accumulated depreciation	95,000	45,000

Calculate cash collections and cash expenses.

	Cash collections	Cash expenses
✓ **A)**	**$202,400**	**$119,900**
✗ **B)**	$202,400	$58,100
✗ **C)**	$197,600	$119,900

Explanation

Cash collections are $202,400 ($200,000 sales + $2,400 increase in unearned revenue). Cash expenses are $119,900 (-$89,000 wages expense - $1,200 decrease in wages payable - $17,000 insurance expense - $1,200 increase in prepaid insurance - $10,400 interest expense - $1,100 decrease in interest payable). Depreciation expense is a non-cash expense.

Question #77 of 118

Question ID: 414250

Consider the following:

Statement #1 - Copyrights and patents are tangible assets that can be separately identified.
Statement #2 - Purchased copyrights and patents are amortized on a straight line basis over 30 years.
With respect to the statements about copyrights and patents acquired from an independent third party:

✗ **A)** **only statement #2 is incorrect.**
✓ **B)** both are incorrect.
✗ **C)** only statement #1 is incorrect.

Explanation

Acquired copyrights and patents are *intangible* assets that can be separately identified. Identifiable intangible assets are amortized over their useful lives.

Question #78 of 118

Question ID: 414348

How does decreasing accounts payable turnover affect a company's cash flow from financing activities and is this source of cash sustainable?

	Financing cash flow	Sustainable source
✗ A)	**Increase**	**No**
✗ B)	No impact	Yes
✓ C)	No impact	No

Explanation

Decreasing accounts payable turnover saves cash by delaying payments to suppliers. The result is an *operating* source of cash, not a financing source. Decreasing accounts payable turnover is not a sustainable source of cash flow because suppliers will refuse to extend credit, at some point, if payment is slower and slower.

Question #79 of 118

Question ID: 414253

At the beginning of 20X7, Bryan's Bakery Company purchased a secret cookie recipe for $25,000. In addition, Bryan developed a new cake recipe at a cost of $5,000. Bryan expects to use both recipes indefinitely; however, the useful (economic) life of similar recipes has been 10 years. Assuming straight-line amortization, what amount of recipe expense should Bryan report for the year ended 20X7 and what amount should Bryan report as assets related to these recipes on its balance sheet at the end of 20X7?

	Recipe expense	Balance sheet
✓ A)	**$7,500**	**$22,500**
✗ B)	$5,000	$25,000
✗ C)	$3,000	$30,000

Explanation

The recipes are intangible assets. The purchased cookie recipe is capitalized and amortized over 10 years at $2,500 per year ($25,000 cost / 10 years). Since the cake recipe was developed internally, it is expensed immediately. Thus, total expense for 20X7 is $7,500 ($2,500 amortization expense + $5,000 cake recipe expense). The balance sheet value of the purchased recipe at the end of 20X7 is $25,000 - $2,500 = $22,500.

Question #80 of 118

Question ID: 414281

Which of the following is NOT a cash flow from operation?

✗ **A) dividends received.**

✗ **B)** interest payments.

✓ **C)** dividends paid to shareholders.

Explanation

Dividends paid are a financing cash flow. Dividends received and interest paid are both operating cash flows.

Question #81 of 118

Question ID: 414233

Which of the following characteristics are required for recognition of a balance sheet asset?

Characteristic #1: Future economic benefits to the firm are probable.

Characteristic #2: The asset is tangible and is obtained at a cost.

	Characteristic #1	Characteristic #2
✗ **A)**	**Yes**	**Yes**
✓ **B)**	Yes	No
✗ **C)**	No	No

Explanation

An asset is recognized on the balance sheet only if it is probable that it will provide future economic benefits. Assets can be tangible or intangible. In some cases, assets are acquired without cost, but will be reported to the extent that they will provide future economic benefit, and thus have value.

Question #82 of 118

Question ID: 414304

Which balance sheet accounts are *most* closely related to the operating activities on a firm's cash flow statement?

✗ **A) Non-current assets.**

✗ **B)** Equity and non-current liabilities.

✓ **C)** Working capital.

Explanation

Typically, operating activities on the cash flow statement are most closely related to the working capital accounts (current assets and current liabilities) on the balance sheet. Investing activities are typically related to non-current assets. Financing activities are typically related to non-current liabilities for transactions with creditors, or equity for transactions with shareholders.

Question #83 of 118

Question ID: 414245

According to International Financial Reporting Standards, how do cash dividends received from trading securities and available-for-sale securities affect net income?

	Trading securities	Available-for-sale securities
✗ A)	**No effect**	**Increase**
✗ B)	Increase	No effect
✓ C)	Increase	Increase

Explanation

Dividends received from trading securities and available-for-sale securities are recognized in the income statement. The difference in trading and available-for-sale classifications relates to the treatment of any unrealized gains and losses.

Question #84 of 118

Question ID: 414326

Juniper Corp. has the following transactions in 20X5.

- Juniper's equipment with a book value of $55,000 was sold for $85,000 cash.
- A parcel of land was purchased for $100,000 worth of Juniper common stock.
- ABC company paid Juniper preferred dividends of $40,000.
- Juniper declared and paid a $100,000 cash dividend.

Under U.S. GAAP, what is cash flow from financing (CFF) for Juniper for 20X5?

✗ **A) −$115,000.**

✓ **B)** −$100,000.

✗ **C)** −$60,000.

Explanation

The only item involving cash flow from financing (CFF) was the payment of a cash dividend by Juniper. The sale of equipment affects cash flow from investing (CFI), the purchase of land has no effect on cash, and the preferred dividends received are cash flow from operations under U.S. GAAP.

Question #85 of 118

Question ID: 414319

When calculating cash flow from operations (CFO) using the indirect method which of the following is *most* accurate?

✗ **A) The indirect method requires an additional schedule to reconcile net income to cash flow.**

✗ **B)** In using the indirect method, each item on the income statement is converted to its cash equivalent.

✓ **C)** When recognizing a gain on the sale of fixed assets, the amount is a deduction to operating cash flows.

Explanation

When recognizing a gain on the sale of fixed assets, the amount is a deduction to operating cash flows. This is because the gain would be double counted in the investing section and in net income. Therefore, the gain must be removed from net income. The direct method of cash flow calculation converts the income statement items to their cash equivalents, not the indirect method. Also, depreciation is added to net income in order to calculate CFO using the indirect method.

Question #86 of 118

Question ID: 414318

Eagle Company's financial statements for the year ended December 31, 20X5 were as follows (in $ millions):

Income Statement

Sales	150
Cost of Goods Sold	(48)
Wages Expense	(56)
Interest Expense	(12)
Depreciation	(22)
Gain on Sale of Equipment	6
Income Tax Expense	(8)
Net Income	10

Balance Sheet

	12-31-X4	*12-31-X5*
Cash	32	52
Accounts Receivable	18	22
Inventory	46	44
Property, Plant & Equip. (net)	182	160
Total Assets	278	278
Accounts Payable	28	33
Long-term Debt	145	135
Common Stock	70	70
Retained Earnings	35	40
Total Liabilities & Equity	278	278

Cash flow from operations (CFO) for Eagle Company for the year ended December 31, 20X5 was (in $ millions).

✓ **A) $29.**
✗ **B)** $37.
✗ **C)** $41.

Explanation

Using the indirect method:

Add: Net Income	$10
Add: Depreciation Expense	22
Less: Gain from Sale of Equip.	(6)
Less: Increase in Accounts Receivable	(4)
Add: Decrease in Inventory	2
Add: Increase in Accounts Payable	5
Cash flow from operations (CFO)	29

Question #87 of 118

Question ID: 414339

Financial information for Jefferson Corp. for the year ended December 31st, was as follows:

Sales	$3,000,000
Purchases	1,800,000
Inventory at Beginning	500,000
Inventory at Ending	800,000
Accounts Receivable at Beginning	300,000
Accounts Receivable at Ending	200,000
Accounts Payable at Beginning	100,000
Accounts Payable at Ending	100,000
Other Operating Expenses Paid	400,000

Based upon this data and using the direct method, what was Jefferson Corp.'s cash flow from operations (CFO) for the year ended December 31st?

✗ **A) $800,000.**

✓ **B)** $900,000.

✗ **C)** $1,200,000.

Explanation

CFO = sales $3,000,000 - change in accounts receivable ($200,000 - $300,000) - purchases $1,800,000 - other cash operating expenses $400,000 = $900,000.

Note that no adjustment for inventories is necessary because purchases are given. From the inventory equation, P = COGS + EI - BI.

Question #88 of 118

Question ID: 414248

At the beginning of the year, Alpha Corporation purchased 10,000 shares of Beta Corporation for $20 per share. During the year, Beta paid a $2,000 cash dividend to Alpha. At the end of the year, Beta's stock was selling for $22 per share. What amount should Alpha recognize in its year-end income statement if the investment is treated as an available-for-sale security and what amount should be recognized in the income statement if the investment is treated as a trading security?

	Available-for-sale	Trading security
✓ **A)**	**$2,000**	**$22,000**
✗ **B)**	$0	$22,000
✗ **C)**	$2,000	$20,000

Explanation

Unrealized gains and losses from trading securities are recognized in the income statement while unrealized gains and losses from available-for-sale securities bypass the income statement and are reported as other comprehensive income, a component of stockholders' equity. Cash dividends are recognized in the income statement for both trading and available-for-sale securities. Thus, Alpha will recognize only the $2,000 dividend if the shares are considered available-for-sale and will recognize $22,000 ($2,000 dividend + $20,000 unrealized gain) if the shares are considered trading securities.

Question #89 of 118

Question ID: 434280

Dart Corporation engaged in the following transactions earlier this year:

Transaction #1: Retired long-term debenture bonds with a face amount of $10 million by issuing 500,000 shares of common stock to the bondholders.

Transaction #2: Borrowed $5 million from a bank and used the proceeds to purchase equipment used in the manufacturing process.

With respect to these transactions, should Dart report transaction #1 as a financing cash flow and/or transaction #2 as an investing cash flow?

- ✗ **A) Both should be reported as such.**
- ✗ **B)** Neither should be reported as such.
- ✓ **C)** Only one should be reported as such.

Explanation

Retiring bonds by issuing common stock to the bondholders is a non-cash transaction and is disclosed separately in a note or supplementary schedule to the cash flow statement, rather than as a financing cash flow. The cash borrowed for the equipment purchase is a financing inflow and the cash cost of the equipment is reported as an investing cash flow in the cash flow statement. Had a bond been issued to the seller of the equipment, it would be treated as a non-cash transaction and reported only in the notes to the cash flow statement.

Question #90 of 118

Question ID: 414322

The net income for Miller Bat Company was $3 million for the year ended December 31, 20X4. Additional information is as follows:

- Depreciation on fixed assets: $1,500,000
- Gain from cash sales of land: 200,000
- Increase in accounts payable: 300,000
- Dividends paid on preferred stock: 400,000

Under U.S. GAAP, the net cash provided by operating activities in the statement of cash flows for the year ended December 31, 20X4 is:

✓ **A) $4,600,000.**

✗ **B)** $4,200,000.

✗ **C)** $4,500,000.

Explanation

$3,000,000 + $1,500,000 − $200,000 + $300,000 = $4,600,000.

Question #91 of 118

Question ID: 414311

An analyst compiled the following information for Universe, Inc. for the year ended December 31, 20X4:

- Net income was $850,000.
- Depreciation expense was $200,000.
- Interest paid was $100,000.
- Income taxes paid were $50,000.
- Common stock was sold for $100,000.
- Preferred stock (eight percent annual dividend) was sold at par value of $125,000.
- Common stock dividends of $25,000 were paid.
- Preferred stock dividends of $10,000 were paid.
- Equipment with a book value of $50,000 was sold for $100,000.

Using the indirect method and assuming U.S. GAAP, what was Universe Inc.'s cash flow from operations (CFO) for the year ended December 31, 20X4?

✓ **A) $1,000,000.**

✗ **B)** $1,015,000.

✗ **C)** $1,050,000.

Explanation

Cash flow from operations (CFO) using the indirect method is computed by taking net income plus non-cash expenses (i.e. depreciation) less gains from the equipment sale. Note that cash flow from operations must be adjusted downward for the amount of the gain on the sale of the equipment. Cash flow from operations is ($850,000 + $200,000 - ($100,000 − $50,000)) = $1,000,000. Note that interest and income taxes paid are expenses shown on the income statement and will already be factored into net income. The other information relates to financial and investing cash flows.

Question #92 of 118

Question ID: 414342

Mark Industries' income statement and related notes for the year ended December 31 are as follows (in $):

Sales	42,000,000
Cost of Goods Sold	(32,000,000)
Wages Expense	(1,500,000)
Depreciation Expense	(2,500,000)
Interest Expense	(1,000,000)
Income Tax Expense	(2,000,000)
Net Income	3,000,000

During the year:

- Wages Payable increased $100,000.
- Accumulated Depreciation increased $2,500,000.
- Interest Payable decreased $200,000.
- Income Taxes Payable increased $500,000.
- Dividends of $100,000 were declared and paid.

Under U.S. GAAP, Mark Industries' cash flow from operations (CFO) for the year ended December 31 was:

✗ **A) $4,800,000.**

✗ **B)** $4,400,000.

✓ **C)** $5,900,000.

Explanation

Using the indirect method, net income is adjusted by adding back depreciation (a non-cash expense) and changes in working capital: the increase in wages payable and the increase in income taxes payable are sources of cash, and the decrease in interest payable is a use of cash. Dividends paid are financing cash flows under U.S. GAAP.

CFO = $3,000,000 + $2,500,000 + $100,000 + $500,000 - $200,000 = $5,900,000.

Question #93 of 118

Question ID: 414323

Galaxy, Inc.'s U.S. GAAP balance sheet as of December 31, 20X4 included the following information (in $):

	12-31-X3	*12-31-X4*
Accounts Payable	300,000	500,000
Dividends Payable	200,000	300,000
Common Stock	1,000,000	1,000,000
Retained Earnings	700,000	1,000,000

Galaxy's net income in 20X4 was $800,000. What was Galaxy's cash flow from financing (CFF) in 20X4?

✓ **A) −$400,000.**

✗ **B)** −$300,000.

✗ **C)** −$500,000.

Explanation

Dividends declared are net income less the increase in retained earnings ($800,000 - $300,000 = $500,000). Dividends declared less the increase in dividends payable is dividends paid ($500,000 - ($300,000 - $200,000) = $400,000). This is a cash outflow so it is a negative number. Dividends paid are always cash flow from financing under U.S. GAAP. Note that accounts payable changes are included in cash flow from operations (CFO).

Question #94 of 118

Question ID: 414312

When using the indirect method for computing cash flow from operating activities, a change in accounts payable will require which of the following?

✓ **A)** **A positive (negative) adjustment to net income when accounts payable increases (decreases).**

✗ **B)** A negative adjustment to net income regardless of whether accounts payable increases or decreases.

✗ **C)** A negative (positive) adjustment to net income when accounts payable increases (decreases).

Explanation

A decrease in accounts payable represents an outflow. Hence, a negative adjustment will be required. Conversely, an increase represents an inflow and a positive adjustment.

Question #95 of 118

Question ID: 414232

Two of the elements of a balance sheet are:

✗ **A)** **equity and cash flows.**

✗ **B)** income and liabilities.

✓ **C)** assets and equity.

Explanation

The three elements of a balance sheet are assets, liabilities, and equity.

Question #96 of 118

Question ID: 414269

Given the following income statement and balance sheet for a company:

Balance Sheet

Assets	*Year 2003*	*Year 2004*
Cash	500	450
Accounts Receivable	600	660

Inventory	500	550
Total CA	1600	1660
Plant, prop. equip	1000	1250
Total Assets	2600	2910
Liabilities		
Accounts Payable	500	550
Long term debt	700	1002
Total liabilities	1200	1552
Equity		
Common Stock	400	538
Retained Earnings	1000	820
Total Liabilities & Equity	2600	2910

Income Statement

Sales	3000
Cost of Goods Sold	(1000)
Gross Profit	2000
SG&A	(500)
Interest Expense	(151)
EBT	1349
Taxes (30%)	(405)
Net Income	944

What is the current ratio for 2004?

- ✗ **A)** **2.018.**
- ✓ **B)** 3.018.
- ✗ **C)** 0.331.

Explanation

Current ratio = (CA / CL) = (1,660 / 550) = 3.018

Question #97 of 118

Question ID: 414246

When the market value of an investment in a debt security is less than its carrying value, how should the investor report the investment on the balance sheet if the security is classified as held-to-maturity and what amount should be reported if the security is classified as available-for-sale?

	Held-to-maturity	Available-for-sale
✗ **A)**	**Fair value**	**Fair value**

✗ **B)**	Amortized cost	Amortized cost
✓ **C)**	Amortized cost	Fair value

Explanation

Held-to-maturity securities are reported on the balance sheet at amortized cost while available-for-sale securities are reported at fair value. Amortized cost includes the amortization of a premium or discount that was created when the security was purchased.

Question #98 of 118

Question ID: 414271

The actual coupon payment on a bond is reported on the statement of cash flow as:

✗ **A) a financing cash outflow.**
✓ **B)** an operating cash outflow.
✗ **C)** an investing cash outflow.

Explanation

The coupon payment is recorded on the statement of cash flows as an operating cash outflow because cash flow from operations includes a deduction for interest expense.

Question #99 of 118

Question ID: 414272

In preparing its cash flow statement for the year ended December 31, 20x4, Giant Corporation collected the following data:

Gain on sale of equipment	$6,000
Proceeds from sale of equipment	10,000
Purchase of Zip Co. bonds for	180,000 (maturity value $200,000)
Amortization of bond discount	2,000
Dividends paid	(75,000)
Proceeds from sale of Treasury stock	38,000

In its December 31, 20x4, statement of cash flows, under U.S. GAAP, what amounts should Giant report as net cash used in investing activities and net cash used in financing activities?

	Investing Activities	Financing Activities
✗ **A)**	**$178,000**	**-$37,000**
✓ **B)**	$170,000	$37,000

✗ **C)** $170,000 -$38,000

Explanation

Investing Activities:
$10,000 - $180,000 = -$170,000 cash flow from investing or $170,000 used

Financing Activities:
$38,000 − $75,000 = -$37,000 cash flow from financing or $37,000 used

Note that the question asked for net cash used therefore this is a positive cash outflow.

Question #100 of 118

Question ID: 414296

What is the difference between the direct and the indirect method of calculating cash flow from operations?

✓ **A) The direct method starts with sales and follows cash as it flows through the income statement, while the indirect method starts with net income and adjusts for non-cash charges and other items.**

✗ **B)** Balance sheet items are not included in the cash flow from operations for the direct method, while they are included for the indirect method.

✗ **C)** The indirect method starts with gross income and adjusts to cash flow from operations, while the direct method starts with gross profit and flows through the income statement to calculate cash flows from operations.

Explanation

The main difference between the direct and indirect methods of calculating cash flows is the way that cash flow from operations is calculated. The direct method starts with sales and follows cash as it flows through the income statement, while the indirect method starts with income after taxes and adjusts backwards for non-cash and other items. Both methods will have the same result for operating cash flows. The direct and indirect method calculates the financing and investing cash flows the same way and both methods will result in the same cash flow figure.

Question #101 of 118

Question ID: 414251

GTO Corporation purchased all of the common stock of Charger Company for $4 million. At the time, Charger reported total assets of $3 million and total liabilities of $1 million. At the acquisition date, the fair value of Charger's assets was $3.5 million and the fair value of Charger's liabilities was $1.3 million. What amount of goodwill should GTO report as a result of the acquisition and is it necessary for GTO to amortize the goodwill?

	Goodwill	Amortization required
✗ **A)**	**$2.2 million**	**No**
✗ **B)**	$1.8 million	Yes
✓ **C)**	$1.8 million	No

Explanation

The acquisition goodwill is equal to $1.8 million [$4 million purchase price - $2.2 million fair value of net assets acquired ($3.5 million assets at fair value - $1.3 million liabilities at fair value)]. Under IFRS or U.S. GAAP, goodwill is not amortized but is subject to an annual impairment test.

Question #102 of 118

Question ID: 414278

What are the main components of cash flow from operations?

✗ **A)** **Repayment of bonds, issuance of common stock, and stock splits.**

✓ **B)** Changes in accounts receivable, inventory, accounts payable, and items that flow through the income statement.

✗ **C)** Capitalization activities, sale of assets, and purchasing securities.

Explanation

The main components of cash flow from operations are changes in working capital items (accounts receivable, inventory, accounts payable), and items that flow through the income statement. Capitalization activities, sale of assets and purchases of securities would all be part of cash flows from investing. Repayment of bonds and issuance of common stock would also be part of cash flows from financing. The stock split would be a non-cash activity.

Question #103 of 118

Question ID: 414313

Given the following information, what is the adjustment to net income when calculating cash flow from operations using the indirect method?

- Increase in accounts payable of $25.
- Sold one share of stock for $15.
- Paid dividends of $10 to shareholders.
- Depreciation expense of $100.
- Increase in inventory of $20.

✗ **A)** **-$95.**

✗ **B)** -$50.

✓ **C)** +$105.

Explanation

Using the indirect method, the increase in accounts payable is a source of cash from operations (+25), depreciation expense is a non-cash expense added back in computing cash from operations (+100), and increase in inventory is a use of cash from operations (-20) = 25 + 100 - 20 = 105. The sale of stock and the dividends paid are financing cash flows that are not included in net income, so they do not require adjustment when calculating CFO.

Question #104 of 118

Question ID: 414247

Earlier this year, Ponca Corporation purchased non-dividend paying equity securities which it classified as trading securities. Information related to the securities follows:

Security	Cost	Fair value at year-end
X	$400,000	$435,000
Y	$550,000	$545,000

What amounts should Ponca report in its year-end income statement and balance sheet as a result of its investment in securities X and Y?

	Income Statement	Balance Sheet
✓ **A)**	**$30,000 unrealized gain**	**$980,000**
✗ **B)**	$30,000 unrealized gain	$950,000
✗ **C)**	No gain or loss	$980,000

Explanation

Trading securities are reported in the balance sheet at fair value. At the end of the year, the fair value of the securities was $980,000 ($435,000 + $545,000). The unrealized gains and losses from trading securities are recognized in the income statement. Thus, Ponca would recognize an unrealized gain of $30,000 ($980,000 fair value - $950,000 cost).

Question #105 of 118

Question ID: 414240

Which of the following statements about a classified balance sheet is *least likely* accurate? A classified balance sheet:

✗ **A) groups accounts by subcategories.**
✗ **B)** distinguishes between current and noncurrent assets.
✓ **C)** presents the net equity of each asset by subtracting its related liability.

Explanation

A classified balance sheet groups assets and liabilities by subcategories. It distinguishes between current and noncurrent assets and current and noncurrent liabilities. The assets and related liabilities are reported separately, they are not netted.

Question #106 of 118

Question ID: 414292

For the year ended December 31, 2007, Gremlin Corporation reported the following transactions:

- Issued 5,000 shares of preferred stock for land with a fair value of $4.8 million.
- Purchased a patent for $3.3 million cash.
- Acquired 40% of the common stock of an affiliate for $2.7 million cash which was borrowed from a bank.
- Exchanged equipment with a book value of $1.7 million for equipment valued at $2.1 million. The exchange was an even

trade.
- Converted bonds payable with a book value of $5 million to 50,000 shares of common stock with a fair value of $6 million.

Calculate Gremlin's cash flow from investing activities and cash flow from financing activities for the year ended December 31, 2007.

	Cash flow from investing activities	Cash flow from financing activities
✓ A)	**$6.0 million outflow**	**$2.7 million inflow**
✗ B)	$2.7 million outflow	$6.0 million inflow
✗ C)	$1.7 million inflow	$1.3 million outflow

Explanation

Only the acquisition of common stock of the affiliate for $2.7 million and the purchase of the patent for $3.3 million are included in cash flow from investing activities. Since the acquisition of the stock purchase was financed with a bank loan, $2.7 million will be reported as a financing inflow. Both remaining transactions are non-cash transactions and are disclosed in the notes to or in a supplementarty schedule to the cash flow statement.

Question #107 of 118

Question ID: 434279

Consider the following statements.

Statement #1:	Par value is a nominal dollar value assigned to shares of stock in a corporation's charter.
Statement #2:	The par value of common stock represents the amount the corporation received when the stock was issued.

With respect to these statements:

✗ A) **only statement #2 is correct.**
✗ B) both statements are correct.
✓ C) only statement #1 is correct.

Explanation

The par value of common stock is the stated or nominal value assigned to the stock. Par value has no relationship to market value. The amount the corporation receives from the issuance of common stock is equal to the par value plus the additional paid-in-capital (proceeds in excess of par).

Question #108 of 118

Question ID: 414314

Impala Corporation reported the following financial information:

	2006	2007

Balance sheet values as of December 31:		
Prepaid insurance	$650,000	$475,000
Interest payable	250,000	300,000
Cash flows for the year ended December 31:		
Insurance premiums paid	$845,000	$750,000
Interest paid	900,000	900,000

Calculate Impala's insurance expense and interest expense for the year ended December 31, 2007.

	Insurance expense	Interest expense
✗ A)	**$925,000**	**$850,000**
✓ B)	$925,000	$950,000
✗ C)	$1,020,000	$950,000

Explanation

Cash paid for insurance = insurance expense + change in prepaid insurance, so insurance expense = cash paid for insurance - change in prepaid insurance. Insurance expense for 2007 is equal to $925,000 [($750,000 cash paid for insurance - (-$175,000)]. Interest expense for 2007 is equal to $950,000 ($900,000 cash interest paid + $50,000 increase in interest payable).

Question #109 of 118

Question ID: 414288

Which of the following items is *least* appropriately described as a liability arising from an operating activity for a non-financial company?

✓ A) **The current portion of long-term debt.**
✗ B) Trade payables.
✗ C) Cash advances from customers.

Explanation

The current portion of long-term debt arises from a financing activity. The other items listed arise from operating activities.

Question #110 of 118

Question ID: 414289

Which of the following choices *most* accurately illustrates an operating liability and which *most* accurately illustrates a financing liability?

	Operating liabilities	Financing liabilities
✓ A)	**Accounts payable**	**Current portion of long-term debt**

✗ **B)**	Short-term note payable	Current portion of long-term debt
✗ **C)**	Customer advances	Accrued liabilities

Explanation

Operating liabilities result from the operations of the firm and consist of operating and trade liabilities such as accounts payable, customer advances, and accrued liabilities. Financing liabilities are a result of prior financing inflows. Financing liabilities (current) include short-term notes payable and the current maturities of long-term debt.

Question #111 of 118

Question ID: 414277

Which of the following should be classified as cash flows from investing (CFI) by Elegant, Inc., which reports under U.S. GAAP?

✗ **A)** **Interest received by Elegant, Inc. on a bond Elegant, Inc. purchased from an outside investor.**

✗ **B)** Dividends received by Elegant, Inc. from an investment in another firm.

✓ **C)** Elegant's payment to purchase equipment to be used in its business.

Explanation

Purchases of equipment are considered to be cash flows from investing. Interest paid or received and dividends received are considered to be cash flows from operations under U.S. GAAP.

Question #112 of 118

Question ID: 414297

The correct set of cash flow treatments as they relate to interest paid according to U.S. generally accepted accounting principles (GAAP) and International Accounting Standards (IAS) GAAP is:

	U.S. GAAP	IAS GAAP
✗ **A)**	**CFO or CFF**	**CFO**
✗ **B)**	CFF	CFF
✓ **C)**	CFO	CFO or CFF

Explanation

U.S. GAAP treats interest paid as CFO whereas IAS GAAP treats interest paid as either CFO or CFF.

Question #113 of 118

Question ID: 414334

An analyst contemplates using the indirect methods to create the projected statement of cash flows. She decides to research the differences between the direct and indirect methods. Which of the following statements is *most* accurate? Under the:

✗ **A)** **indirect method, changes in accounts receivable are already included in the net income figure.**

✗ **B)** direct method, depreciation must be added to cash collections because it is a non-cash expense.

✓ **C)** indirect method, depreciation must be added to net income, because it is a non-cash expense.

Explanation

The indirect method begins with net income, which has already included all cash and non-cash expenses. Therefore, under the indirect method, depreciation must be added to net income, because it is a non-cash expense.

Question #114 of 118

Question ID: 414259

Which of the following transactions is *most likely* to be recognized on a firm's statement of changes in equity?

✗ **A)** **Investing cash in an exchange-traded fund.**

✓ **B)** Declaring a dividend on common shares.

✗ **C)** Buying a machine from an equipment dealer.

Explanation

Declaring a dividend decreases shareholders' equity and is reflected on the statement of changes in shareholders' equity. Buying a machine is unlikely to change shareholders' equity at the time of purchase. Investing cash in a security is an exchange of one asset for another and is also unlikely to change shareholders' equity at the time of the investment.

Question #115 of 118

Question ID: 414231

Resources controlled as a result of past transactions that are expected to provide future benefits are referred to as:

✗ **A)** **equity.**

✓ **B)** assets.

✗ **C)** liabilities.

Explanation

Assets are resources that are expected to provide future benefits and are controlled as a result of past transactions. Liabilities are obligations resulting from past events that are expected to require a future outflow of resources. Equity is a residual interest in assets after deducting liabilities.

Question #116 of 118

Question ID: 414324

Determine the cash flow from investing given the following table:

Item	*Amount*
Cash payment of dividends	$30

Sale of equipment	$25
Net income	$25
Purchase of land	$15
Increase in accounts payable	$20
Sale of preferred stock	$25
Increase in deferred taxes	$5

✗ **A)** **-$5.**

✓ **B)** $10.

✗ **C)** -$10.

Explanation

Item		*Amount*
Cash payment of dividends	CFF	-$30
Sale of equipment	CFI	+$25
Net income	CFO	+$25
Purchase of land	CFI	-$15
Increase in accounts payable	CFO	+$20
Sale of preferred stock	CFF	+$25
Increase in deferred taxes	CFO	+$5

CFI = Sale of Equipment (+25) + Purchase of Land (-15) = $10.

Question #117 of 118

Question ID: 414352

The RR Corporation had cash flow from operations of $20 million. RR purchased $5 million in equipment and sold $3 million of equipment during the period. What is RR's free cash flow to equity for the period?

✓ **A)** **$18 million.**

✗ **B)** $15 million.

✗ **C)** $22 million.

Explanation

Free cash flow to equity (FCFE) is generally defined as cash flow from operations (CFO) less net fixed capital expenditures plus net borrowing. No information on borrowing is given here, so FCFE = 20 − (5 − 3) = $18 million.

Question #118 of 118

Question ID: 414301

For the year ended December 31, 2007, Challenger Company reported the following financial information:

Revenue	$100,000
Cost of goods sold	(40,000)

Cash operating expenses	(20,000)
Depreciation expense	(5,000)
Tax expense	(3,000)
Net income	$32,000
Increase in accounts receivable	$7,500
Decrease in inventory	$2,500
Increase in short-term notes payable	$3,000
Decrease in accounts payable	$1,000

Calculate cash flow from operating activities using the direct method and the indirect method.

	Direct method	Indirect method
✗ A)	**$31,000**	**$34,000**
✓ B)	$31,000	$31,000
✗ C)	$34,000	$34,000

Explanation

CFO is the same under both methods, the only difference is presentation. Direct method: $92,500 cash collections ($100,000 revenue - $7,500 increase in receivables) - $38,500 cash paid to suppliers (- $40,000 COGS + $2,500 decrease in inventory - $1,000 decrease in payables) - $20,000 cash operating expenses - $3,000 tax expense = $31,000. Indirect method: $32,000 net income + $5,000 depreciation expense - $7,500 increase in receivables + $2,500 decrease in inventory - $1,000 decrease in payables = $31,000. The increase in short-term notes payable is a financing activity.