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Name: ________________________ Class: ________________ Date: __________

CHAPTER 2 - FINANCIAL STATEMENTS, CASH FLOW, AND TAXES

1. In Canada, amortization is a concept similar to depreciation and can be applied to both tangible and intangible assets.

a. True

b. False

ANSWER: True

2. The income statement shows the difference between a firm's income and its costs—i.e., its profits—during a specified period of time. However, not all reported income comes in the form of cash, and reported costs likewise may not correctly reflect cash outlays. Therefore, there may be a substantial difference between a firm's reported profits and its actual cash flow for the same period.

a. True

b. False

ANSWER: True

3. Income statements must be prepared only on an annual basis.

a. True

b. False

ANSWER: False

4. Total net before-tax operating income is equal to net fixed assets.

a. True

b. False

ANSWER: False

5. Net operating profit after taxes (NOPAT) is the amount of net income a company would generate from its operations if it had no interest income or interest expense.

a. True

b. False

ANSWER: True

6. The fact that interest income received by a corporation is 50% taxable encourages firms to use more debt financing than equity financing.

a. True

b. False

ANSWER: False

7. If the tax laws were changed so that \$0.50 out of every \$1.00 of interest paid by a corporation was allowed as a tax-deductible expense, this would probably encourage companies to use more debt financing than they currently do, other things held constant.

a. True

b. False

ANSWER: False

8. The interest and dividends paid by a corporation are considered to be deductible operating expenses; hence, they decrease the firm's tax liability.

a. True

b. False

ANSWER: False

9. The balance sheet is a financial statement that measures the flow of funds into and out of various accounts over time, while the income statement measures the firm's financial position at a point in time.

a. True

b. False

ANSWER: False

10. The FIFO method leads to a higher balance sheet inventory value but a lower cost of goods sold in the income statement.

a. True

b. False

ANSWER: True

11. The value of goodwill on intangible assets is calculated according to the impairment rule instead of a fixed annual charge.

a. True

b. False

ANSWER: True

12. Retained earnings are the existing shareholders' reinvested profit and do not represent cash.

a. True

b. False

ANSWER: True

13. Since investors use net income to value the firm, cash flow becomes a secondary consideration simply because cash is for operation only.

a. True

b. False

ANSWER: False

14. The current cash flow from existing assets is highly relevant to the investor. However, since the value of the firm depends primarily upon its growth opportunities, profit projections from those opportunities are the only relevant future flows with which investors are concerned.

a. True

b. False

ANSWER: False

15. The time dimension is important in financial statement analysis. The balance sheet shows the firm's financial position at a given point in time, the income statement shows results over a period of time, and the statement of cash flows reflects changes in the firm's accounts over that period of time.

a. True

b. False

ANSWER: True

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CHAPTER 2 - FINANCIAL STATEMENTS, CASH FLOW, AND TAXES

16. Which statement about financial statements is correct?
    a. The balance sheet gives us a picture of the firm's financial position at a point in time.
    b. The income statement gives us a picture of the firm's financial position at a point in time.
    c. The statement of cash flows tells us how much cash the firm has in the form of currency and demand deposits.
    d. The statement of cash needs tells us how much cash the firm will require during some future period, generally a month or a year.

ANSWER: a

17. Which statement about the balance sheet is true?
    a. The balance sheet for a given year is designed to give us an idea of what happened to the firm during that year.
    b. The balance sheet for a given year tells us how much money the company earned during that year.
    c. For most companies, the market value of the stock equals the book value of the stock as reported on the balance sheet.
    d. A balance sheet lists the assets that will be converted to cash first and the longest-lived ones last.

ANSWER: d

18. Other things held constant, which action would increase the amount of cash on a company's balance sheet?
    a. The company purchases a new piece of equipment.
    b. The company pays a dividend.
    c. The company issues new common stock.
    d. The company gives customers more time to pay their bills.

ANSWER: c

19. Which of the following items is **NOT** included in current assets?
    a. accounts receivable
    b. Inventory
    c. Bonds
    d. Cash

ANSWER: c

20. Which of the following items cannot be found on a firm's balance sheet under current liabilities?
    a. accounts payable
    b. short-term notes payable to the bank
    c. accrued wages
    d. cost of goods sold

ANSWER: d

21. Which statement about the income statement is true?
    a. The focal point of the income statement is the cash account, because that account cannot be manipulated by "accounting tricks."
    b. EBITDA is a truer measure of financial strength than are net income and free cash flow.

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c. If a firm follows the International Financial Reporting Standard (IFRS), its reported net income and net cash flow will be the same.

d. The income statement for a given year is designed to give us an idea of how much the firm earned during that year.

ANSWER: d

22. Below are the 2011 and 2012 year-end balance sheets for Wolken Enterprises:

		2012	2011
Assets:			
Cash		$ 200,000	$ 170,000
Accounts receivable		864,000	700,000
Inventories		2,000,000	1,400,000
Total current assets		$ 3,064,000	$2,270,000
Net fixed assets		6,000,000	5,600,000
Total assets		$ 9,064,000	$7,870,000
Liabilities and equity:			
Accounts payable		$ 1,400,000	$1,090,000
Notes payable		1,600,000	1,800,000
Total current liabilities	$ 3,000,000		$2,890,000
Long-term debt		2,400,000	2,400,000
Common stock		3,000,000	2,000,000
Retained earnings		664,000	580,000
Total common equity		$ 3,664,000	$2,580,000
Total liabilities and equity	$ 9,064,000		$7,870,000

Wolken has never paid a dividend on its common share, and it issued $2,400,000 of 10-year non-callable, long-term debt in 2011. As of the end of 2012, none of the principal on this debt had been repaid. Assume that the company's sales in 2011 and 2012 were the same. Which of the following statements must be correct?

a. Wolken increased its short-term bank debt in 2012.

b. Wolken issued long-term debt in 2012.

c. Wolken issued new common shares in 2012.

d. Wolken repurchased some common shares in 2012.

ANSWER: c

23. On its 2012 balance sheet, Barngrover Books showed $510 million of retained earnings, and exactly that same amount was shown the following year. Assuming that no earnings restatements were issued, which of the following statements is correct?

a. Although the company lost money in 2012, it must have paid dividends.

b. The company must have had zero net income in 2012.

c. The company must have paid no dividends in 2012.

d. Dividends could have been paid in 2012, with amounts equal to the earnings for the year.

ANSWER: d

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24. Below is the common equity section (in millions) of Teweles Technology's last two year-end balance sheets:

	2012	2011
Common share	$2,000	$1,000
Retained earnings	2,000	2,340
Total common equity	$4,000	$3,340

Teweles has never paid a dividend to its common shareholders. Which of the following statements is correct?

a. The company's net income in 2012 was higher than in 2011.
b. Teweles issued common stock in 2012.
c. The market price of Teweles's stock doubled in 2012.
d. The company has more equity than debt on its balance sheet.

ANSWER: b

25. Which of the following statements is correct?

a. Typically, a firm's DPS should exceed its EPS.
b. Typically, a firm's EBIT should exceed its EBITDA.
c. With an excellent profit record, a firm stock price exceeds its book value per share.
d. The more depreciation a firm has in a given year, the higher its EPS, other things held constant.

ANSWER: c

26. Which statement about depreciation is true?

a. The more depreciation a firm reports, the higher its tax bill, other things held constant.
b. Depreciation reduces a firm's cash balance, so an increase in depreciation would normally lead to a reduction in the firm's net cash flow.
c. Net Cash Flow = Net Income + Depreciation and Amortization Charges.
d. Depreciation and amortization are not cash charges, so neither has an effect on a firm's reported profits.

ANSWER: c

27. What would be most likely to occur in the year when companies have to depreciate equipment over longer lives? Assume that sales, other operating costs, and tax rates are not affected, and the same depreciation method is used for tax and shareholder reporting purposes.

a. Companies' NOPAT would decline.
b. Companies' physical stocks of fixed assets would increase.
c. Companies' net cash flows would increase.
d. Companies' cash positions would decline.

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ANSWER: d

28. Which factor could explain why Dellva Energy had a negative net cash flow last year, even though the cash on its balance sheet increased?
    a. The company sold a new issue of bonds.
    b. The company made a large investment in new plant and equipment.
    c. The company paid a large dividend.
    d. The company had high amortization expenses.

ANSWER: a

29. Analysts who follow Howe Industries recently noted that, relative to the previous year, the company's operating net cash flow *increased*, yet cash as reported on the balance sheet *decreased*. Which factor could explain this situation?
    a. The company cut its dividend.
    b. The company made a large investment in a profitable new plant.
    c. The company sold a division and received cash in return.
    d. The company issued new long-term debt.

ANSWER: b

30. A security analyst obtained the following information from Prestopino Products' financial statements:
– Retained earnings at the end of 2011 were $700,000, but retained earnings at the end of 2012 had declined to $320,000.
– The company does not pay dividends.
– The company's depreciation expense is its only non-cash expense; it has no amortization charges.
– The company has no non-cash revenues.
– The company's net cash flow (NCF) for 2012 was $150,000.

On the basis of this information, which of the following statements is correct?
    a. Prestopino had negative net income in 2012.
    b. Prestopino's depreciation expense in 2012 was less than $150,000.
    c. Prestopino had positive net income in 2012, but its income was less than its 2011 income.
    d. Prestopino's NCF in 2012 must be higher than its NCF in 2011.

ANSWER: a

31. Aubey Aircraft recently announced that its net income increased sharply from the previous year, yet its net cash flow from operations declined. What could explain this performance?
    a. The company's operating income declined.
    b. The company's expenditures on fixed assets declined.
    c. The company's cost of goods sold increased.
    d. The company's depreciation and amortization expenses declined.

ANSWER: d

32. Which statement regarding the statement of cash flows is correct?
    a. The statement of cash flows reflects cash flows from operations, but it does not reflect the effects of buying or selling fixed assets.
    b. The statement of cash flows reflects cash flows from continuing operations, but it does not reflect the effects

of changes in working capital.

c. The statement of cash flows reflects cash flows from operations and from borrowings, but it does not reflect cash obtained by selling new common stock.

d. The statement of cash flows shows how much the firm's cash—the total of currency, bank deposits, and short-term liquid securities (or cash equivalents)—increased or decreased during a given year.

ANSWER: d

33. Which statement regarding the statement of cash flows is true?

a. In the statement of cash flows, a *decrease* in accounts receivable is reported as a use of cash.

b. In the statement of cash flows, a *decrease* in accounts payable is reported as a use of cash.

c. In the statement of cash flows, depreciation charges are reported as a use of cash.

d. In the statement of cash flows, a *decrease* in inventories is reported as a use of cash.

ANSWER: b

34. The standard financial statements prepared by accountants have to be modified for managerial purposes. Related to these modifications, which of the following statements is correct?

a. The standard statements make adjustments to reflect the effects of inflation on asset values, and these adjustments are normally carried into any adjustment that managers make to the standard statements.

b. The standard statements focus on accounting income for the entire corporation, not cash flows, and the two can be quite different during any given accounting period.

c. The standard statements provide useful information on the firm's individual operating units, but management needs more information on the firm's overall operations than the standard statements provide.

d. The standard statements focus on cash flows, but managers are less concerned with cash flows than with accounting income as defined by GAAP.

ANSWER: b

35. Which of the following statements is correct?

a. Changes in working capital have no effect on free cash flow.

b. Free cash flow (FCF) is defined as follows:
FCF = EBIT(1 – T)
+ Depreciation and Amortization
– Capital expenditures required to sustain operations
– Required changes in net operating working capital

c. Free cash flow (FCF) is defined as follows:
FCF = EBIT(1 – T) + Depreciation and Amortization + Capital expenditures

d. Operating cash flow is the same as free cash flow (FCF).

ANSWER: b

36. Which of the following statements is correct?

a. MVA gives us an idea about how much value a firm's management has added during the last year.

b. MVA stands for market value added, and it is defined as follows:
MVA = (Shares outstanding) (Stock price) + Book value of common equity

c. EVA stands for economic value added, and it is defined as follows:
EVA = (Operating capital) (ROIC – WACC)

d. EVA gives us an idea about how much value a firm's management has added over the firm's life.

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ANSWER: c

37. Which statement regarding the tax system is true?
    a. Since companies can deduct dividends paid but not interest paid, such a tax system favours the use of equity financing over debt financing.
    b. Interest paid to an individual is counted as income for tax purposes and taxed at the individual's regular tax rate.
    c. The maximum federal personal tax rate in 2012 is 35%.
    d. Ordinary corporate operating losses can be carried back to each of the preceding 10 years and forward for the next 3 years and used to offset taxable income in those years.

ANSWER: b

38. Which statement regarding the tax system is true?
    a. For small Canadian-controlled private corporations, income less than $400,000 is exempt from taxes. Thus, government receives no tax revenue from these businesses.
    b. All businesses, regardless of their legal form of organization, are taxed by the Canada Revenue Agency (CRA).
    c. Corporate income taxes are influenced by the size and location of the companies and their income types.
    d. All corporations other than nonprofit corporations are subject to corporate income taxes, which are 26.5% for the lowest amounts of income and 32.5% for the highest amounts of income.

ANSWER: c

39. Last year, Tucker Technologies had (1) a negative net cash flow from operations, (2) a negative free cash flow, and (3) an increase in cash as reported on its balance sheet. Which factor could explain this situation?
    a. The company had a sharp increase in its inventories.
    b. The company had a sharp increase in its accrued liabilities.
    c. The company sold a new issue of common stock.
    d. The company made a large capital investment early in the year.

ANSWER: c

40. Assume that Bev's Beverages Inc. (BBI) can double its depreciation expense for the upcoming year while sales revenue and tax rate remain unchanged. Prior to the change, BBI's net income after taxes was forecasted to be $4 million. What impact will this change have on BBI's financial statements? Assume that the company uses the same depreciation method for tax and shareholder reporting purposes.
    a. The provision will reduce the company's net cash flow.
    b. The provision will increase the company's tax payments.
    c. Net fixed assets on the balance sheet will increase.
    d. Net fixed assets on the balance sheet will decrease.

ANSWER: d

41. The Nantell Corporation just purchased an expensive piece of equipment. Originally, the firm planned to depreciate the equipment over 5 years on a straight-line basis, but now wants to depreciate the equipment on a straight-line basis over 7 years. Other things held constant, what will occur as a result of this change? Assume that the company uses the same depreciation method for tax and stockholder reporting purposes.
    a. Nantell's taxable income will be lower.

b. Nantell's net fixed assets as shown on the balance sheet will be higher at the end of the year.

c. Nantell's cash position will improve (increase).

d. Nantell's tax liability for the year will be lower.

ANSWER: b

42. Assume that Pappas Company commenced operations on January 1, 2011, and it was granted permission to use the same depreciation calculations for shareholder reporting and income tax purposes. The company planned to depreciate its fixed assets over 15 years, but in December 2008 management realized that the assets would last for only 10 years. The firm's accountants plan to report the 2011 financial statements based on this new information. How would the new depreciation assumption affect the company's financial statements?

a. The firm's reported net fixed assets would increase.

b. The firm's EBIT would increase.

c. The firm's reported 2011 earnings per share would increase.

d. The firm's cash position in 2011 and 2012 would increase.

ANSWER: d

43. A start-up firm is making an initial investment in new plant and equipment. Assume that currently its equipment must be depreciated on a straight-line basis over 10 years, but now the company is allowed to depreciate the equipment over 7 years. What would occur in the year following the change?

a. The firm's operating income (EBIT) would increase.

b. The firm's net cash flow would increase.

c. The firm's tax payments would increase.

d. The firm's reported net income would increase.

ANSWER: b

44. Which statement regarding financial statements is true?

a. Dividends paid reduce the net income that is reported on a company's income statement.

b. If a company uses some of its bank deposits to buy short-term, highly liquid marketable securities, this will cause a decline in its current assets as shown on the balance sheet.

c. If a company issues new long-term bonds during the current year, this will increase its reported current liabilities at the end of the year.

d. If a company pays more in dividends than it generates in net income, its retained earnings as reported on the balance sheet will decline from the previous year's balance.

ANSWER: d

45. Which statement regarding EVA is true?

a. One way to increase EVA is to achieve the same level of operating income but with more investor-supplied capital.

b. If a firm reports positive net income, its EVA must also be positive.

c. One drawback of EVA as a performance measure is that it mistakenly assumes that equity capital is free.

d. One way to increase EVA is to generate the same level of operating income but with less investor-supplied capital.

ANSWER: d

46. Which statement regarding retained earnings is true?

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a. Since depreciation is a source of funds, the more depreciation a company has, the larger its retained earnings will be, other things held constant.
b. A firm can show a large amount of retained earnings on its balance sheet yet need to borrow cash to make required payments.
c. The retained earnings account as shown on the balance sheet shows the amount of cash that is available for paying dividends.
d. If a firm reports a loss on its income statement, then the retained earnings account as shown on the balance sheet will be negative.

ANSWER: b

47. The CFO of Shalit Industries plans to have the company issue $300 million of new common stock and use the proceeds to pay off some of its outstanding bonds. Assume that the company, which does not pay any dividends, takes this action, and that total assets, operating income (EBIT), and its tax rate all remain constant. Which of the following would occur?

a. The company's taxable income would fall.
b. The company would have less common equity than before.
c. The company's net income would increase.
d. The company would have to pay less tax.

ANSWER: c

48. Last year Roussakis Company's operations provided a negative net cash flow, yet the cash shown on its balance sheet increased. What action could explain the increase in cash, assuming the company's financial statements were prepared under generally accepted accounting principles?

a. The company repurchased some of its common stock.
b. The company retired a large amount of its long-term debt.
c. The company sold some of its fixed assets.
d. The company had high depreciation expenses.

ANSWER: c

49. Tucker Electronic System's current balance sheet shows total common equity of $3,125,000. The company has 125,000 shares of stock outstanding, and they sell at a price of $52.50 per share. By how much do the firm's market and book values per share differ?

a. $27.50
b. $28.88
c. $30.32
d. $31.83

ANSWER: a

50. Hunter Manufacturing Inc.'s December 31, 2011,balance sheet showed total common equity of $2,050,000 and 100,000 shares of stock outstanding. During 2012, Hunter had $250,000 of net income, and it paid out $100,000 as dividends. What was the book value per share at 12/31/12, assuming that Hunter neither issued nor retired any common stock during 2009?

a. $20.90
b. $22.00
c. $23.10

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d. $24.26

ANSWER: b

51. Companies generate income from their "regular" operations and from other sources such as interest earned on the securities they hold, which is called non-operating income. Lindley Textiles recently reported $12,500 of sales, $7,250 of operating costs other than depreciation, and $1,000 of depreciation. The company had no amortization charges and no non-operating income. It had $8,000 of bonds outstanding that carry a 7.5% interest rate, and its combined federal and provincial income tax rate was 40%. How much was Lindley's operating income, or EBIT?

a. $3,644
b. $3,836
c. $4,038
d. $4,250

ANSWER: d

52. Frederickson Office Supplies recently reported $12,500 of sales, $7,250 of operating costs other than depreciation, and $1,250 of depreciation. The company had no amortization or depreciation charges and no nonoperating income. It had $8,000 of bonds outstanding that carry a 7.5% interest rate, and its combined federal and provincial income tax rate was 40%. How much was the firm's taxable income, or earnings before taxes (EBT)?

a. $3,230.00
b. $3,400.00
c. $3,570.00
d. $3,748.50

ANSWER: b

53. JBS Inc. recently reported net income of $4,750 and depreciation of $885. How much was its net cash flow, assuming it had no amortization expense and sold none of its fixed assets?

a. $4,831.31
b. $5,085.59
c. $5,353.25
d. $5,635.00

ANSWER: d

54. Swinnerton Clothing Company's balance sheet showed total current assets of $2,250, all of which were required in operations. Its current liabilities consisted of $575 of accounts payable, $300 of 6% short-term notes payable to the bank, and $145 of accrued wages and taxes. What was its net operating working capital that was financed by investors?

a. $1,454
b. $1,530
c. $1,607
d. $1,771

ANSWER: b

55. Over the years, Janjigian Corporation's shareholders have provided $15,250 of capital, part when they purchased new issues of stock and part when they allowed management to retain some of the firm's earnings. The firm now has 1,000 shares of common share outstanding, and it sells at a price of $42.00 per share. How much value has Janjigian's management added to stockholder wealth over the years, i.e., what is Janjigian's MVA?

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a. $22,935
b. $24,142
c. $25,413
d. $26,750

ANSWER: d

56. An individual made $48,000 last year paying $12,480 in taxes. What is the taxpayer's average tax rate?

a. 17.4%
b. 22.1%
c. 26.0%
d. 30.9%

ANSWER: c

57. Meric Mining Inc. recently reported $15,000 of sales, $7,500 of operating costs other than depreciation, and $1,200 of depreciation. The company had no amortization charges, it had outstanding $6,500 of bonds that carry a 6.25% interest rate, and its combined federal and provincial income tax rate was 35%. How much was the firm's net income after taxes? Meric uses the same depreciation expense for tax and shareholder reporting purposes.

a. $3,284.55
b. $3,457.42
c. $3,639.39
d. $3,830.94

ANSWER: d

58. On 12/31/12, Heaton Industries Inc. reported retained earnings of $675,000 on its balance sheet, and it reported that it had $172,500 of net income during the year. On its previous balance sheet, at 12/31/11, the company had reported $555,000 of retained earnings. No shares were repurchased during 2012. How much in dividends did Heaton pay during 2012?

a. $47,381
b. $49,875
c. $52,500
d. $55,125

ANSWER: c

59. During 2012, Bascom Bakery Inc. paid out $21,750 of common dividends. It ended the year with $187,500 of retained earnings versus the prior year's retained earnings of $132,250. How much net income did the firm earn during the year?

a. $77,000
b. $80,850
c. $84,893
d. $89,137

ANSWER: a

60. NNR Inc.'s balance sheet showed total current assets of $1,875,000 plus $4,225,000 of net fixed assets. All of these assets were required in operations. The firm's current liabilities consisted of $475,000 of accounts payable, $375,000 of 6% short-term notes payable to the bank, and $150,000 of accrued wages and taxes. Its remaining capital consisted of

long-term debt and common equity. What was NNR's total investor-provided operating capital?

a. $4,694,128
b. $4,941,188
c. $5,201,250
d. $5,475,000

ANSWER: d

61. Last year Tiemann Technologies reported $10,500 of sales, $6,250 of operating costs other than depreciation, and $1,300 of depreciation. The company had no amortization charges, it had $5,000 of bonds that carry a 6.5% interest rate, and its combined federal and provincial income tax rate was 35%. This year's data are expected to remain unchanged except for one item, depreciation, which is expected to increase by $750. By how much will net after-tax income change as a result of the change in depreciation? The company uses the same depreciation calculations for tax and stockholder reporting purposes.

a. –463.13
b. –487.50
c. –511.88
d. –537.47

ANSWER: b

62. TSW Inc. had the following data for last year: Net income = $800; Net operating profit after taxes (NOPAT) = $700; Total assets = $3,000; and Total operating capital = $2,000. Information for the just-completed year is as follows: Net income = $1,000; Net operating profit after taxes (NOPAT) = $925; Total assets = $2,600; and Total operating capital = $2,500. How much free cash flow did the firm generate during the just-completed year?

a. $383
b. $425
c. $468
d. $514

ANSWER: b

63. Rao Corporation has the following balance sheet. How much net operating working capital does the firm have?

Cash	$ 10	Accounts payable	$ 20
Short-term investments	30	Accruals	20
Accounts receivable	50	Notes payable	50
Inventory	40	Current liabilities	$ 90
Current assets	$130	Long-term debt	0
Net fixed assets	100	Common equity	30
Retained earnings	50		
Total assets	$230	Total liab. & equity	$230

a. $54.00
b. $60.00
c. $66.00
d. $72.60

ANSWER: b

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64. Bae Inc. has the following income statement. How much net operating profit after taxes (NOPAT) does the firm have?

Sales		$2,000.00
Costs		1,200.00
Depreciation	100.00	
EBIT		$ 700.00
Interest expense	200.00	
EBT		$ 500.00
Taxes (35%)	175.00	
Net income	$ 325.00	

a. $390.11
b. $410.64
c. $432.25
d. $455.00

ANSWER: d

65. EP Enterprises has the following income statement. How much net operating profit after taxes (NOPAT) does the firm have?

Sales	$1,800.00
Costs	1,400.00
Depreciation	250.00
EBIT	$ 150.00
Interest expense	70.00
EBT	$ 80.00
Taxes (40%)	32.00
Net income	$ 48.00

a. $81.23
b. $85.50
c. $90.00
d. $94.50

ANSWER: c

66. Tibbs Inc. had the following data for the year ending 12/31/12: Net income = $300; Net operating profit after taxes (NOPAT) = $400; Total assets = $2,500; Short-term investments = $200; Shareholders' equity = $1,800; Total debt = $700; and Total operating capital = $2,300. What was its return on invested capital (ROIC)?

a. 14.91%
b. 15.70%
c. 16.52%
d. 17.39%

ANSWER: d

67. Zumbahlen Inc. has the following balance sheet. How much total operating capital does the firm have?

Cash	$ 20.00	Acco	$ 30.00

		unts payable	
Short-term investments	50.00	Accruals	50.00
Accounts receivable	20.00	Notes payable	30.00
Inventory	60.00	Current Liabilities	110.00
Current assets		Long-term debt	70.00
Gross fixed assets	$140.00	Common stock	30.00
Accumulated depreciation	40.00	Retained earnings	40.00
Net fixed assets	$100.00	Total common equity	$ 70.00
Total assets	$250.00	Total liability & equity	$250.00

a. $114.00
b. $120.00
c. $126.00
d. $132.30

ANSWER: b

68. Barnes’ Brothers has the following data for the year ending 12/31/07: Net income = $600; Net operating profit after taxes (NOPAT) = $700; Total assets = $2,500; Short-term investments = $200; Stockholders’ equity = $1,800; Total debt = $700; and Total operating capital = $2,100. Barnes’ weighted average cost of capital is 10%. What is its economic value added (EVA)?

a. $420.11
b. $442.23

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c. $465.50
d. $490.00

ANSWER: d

69. If a local Firm X owns 35% of the shares of a Canadian-owned Firm Y, and Y pays dividends to all of its shareholders, what percentage of the dividends received by X can be exempted from its taxable income?

a. 0%
b. 35%
c. 65%
d. 100%

ANSWER: d

70. What is the tax liability for a small Canadian-controlled private corporation (CCPC) located in British Columbia having earnings before taxes (EBT) of $480,000? The relevant combined federal and provincial corporate income tax rate is 13.5% for taxable income up to $400,000 and 26.5 for the amount exceeding $400,000.

a. $64,800
b. $75,200
c. $96,000
d. $127,200

ANSWER: b

71. Formed in 2008, ABC Ltd. had taxable income of $95,000 in 2008; $70,000 in 2009; $55,000 in 2010; $80,000 in 2011, and –$150,000 in 2012. What is the adjusted corporate tax payment in 20012? Assume that ABC is a CCPC in Manitoba with a combined federal and provincial corporate income tax rate of 13%.

a. $17,150.00
b. $18,100.00
c. $19,500.00
d. $20,550.00

ANSWER: c

72. Formed in 2012, ABC Ltd. had an operating loss of $95,000, with projected taxable income of $70,000 in 2013, $55,000 in 2014, and $80,000 in 2015. What will the corporate tax liability be in 2015? Assume that ABC is a CCPC in Quebec with a combined federal and provincial corporate income tax rate of 19%.

a. $15,200.00
b. $16,250.00
c. $17,700.00
d. $18,500.00

ANSWER: a

73. In 2012, XYZ Inc. located in Ontario had income from operation of $3,850,000, received interest of $150,000, paid $200,000 in interest, received dividends from another Canadian corporation of $100,000, and paid $400,000 in dividends to its common shareholders. If the applicable income tax rate is 33%, what is the corporation's tax liability?

a. $1,155,000
b. $1,254,000

c. $1,287,000
d. $1,353,000

ANSWER: b

74. An individual living in Alberta with wage earnings of $65,000 has invested $25,000 for 1 year in corporate bonds yielding 6%. What is the after-tax return? The relevant federal and provincial tax rates are 22% and 10%.

a. $480
b. $880
c. $1,020
d. $1,500

ANSWER: c

75. Wells Water Systems recently reported $8,250 of sales, $4,500 of operating costs other than depreciation, and $950 of depreciation. The company had no amortization charges, it had $3,250 of outstanding bonds that carry a 6.75% interest rate, and its combined federal and provincial income tax rate was 35%. In order to sustain its operations and thus generate sales and cash flows in the future, the firm was required to spend $750 to buy new fixed assets and to invest $250 in net operating working capital. How much free cash flow did Wells generate?

a. $1,770.00
b. $1,858.50
c. $1,951.43
d. $2,049.00

ANSWER: a

76. HHH Inc. reported $12,500 of sales and $7,025 of operating costs (including depreciation). The company had $18,750 of investor-supplied operating assets (or capital), the weighted average cost of that capital (the WACC) was 9.5%, and the combined federal and provincial income tax rate was 40%. How much value did management add to shareholders' wealth during the year?

a. $1,357.13
b. $1,428.56
c. $1,503.75
d. $1,578.94

ANSWER: c

77. Last year, Michelson Manufacturing reported $10,250 of sales, $3,500 of operating costs other than depreciation, and $1,250 of depreciation. The company had no amortization charges, it had $3,500 of bonds outstanding that carry a 6.5% interest rate, and its combined federal and provincial income tax rate was 35%. This year's data are expected to remain unchanged except for one item, depreciation, which is expected to increase by $725. By how much will the depreciation change cause the firm's net after-tax income and its net cash flow to change? Note that the company uses the same depreciation calculations for tax and stockholder reporting purposes.

a. –$404.04; $217.56
b. –$425.30; $229.01
c. –$447.69; $241.06
d. –$471.25; $253.75

ANSWER: d

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CHAPTER 2 - FINANCIAL STATEMENTS, CASH FLOW, AND TAXES

78. Bartling Energy Systems recently reported $9,250 of sales, $5,750 of operating costs other than depreciation, and $700 of depreciation. The company had no amortization charges, it had $3,200 of outstanding bonds that carry a 5% interest rate, and its combined federal and provincial income tax rate was 35%. In order to sustain its operations and thus generate sales and cash flows in the future, the firm was required to make $1,250 of capital expenditures on new fixed assets and to invest $300 in net operating working capital. By how much did the firm's net income exceed its free cash flow?

a. $673.27
b. $708.70
c. $746.00
d. $783.30

ANSWER: c

79. Mr. X lives in Saskatchewan. In 2011, he had employment income of $80,000 and income from capital gains of $10,000. What is his total tax liability? The applicable tax tables are as follows:

Federal Rate
Tax Bracket
Provincial Rate
Tax Bracket

Fed. 15%
$0 – $41,544
Sask. 11%
$0 – $40,919

Fed. 22%
$41,544 – $83,088
Sask. 13%
$40.919 – $116,911

Fed. 26%
$83,088 – $128,800
Sask. 15%
Over $116,911

Fed. 29%
Over $128,800

a. $20,774
b. $24,274
c. $26,100
d. $28,050

ANSWER: c

80. The annual financial statements of a firm contain which of the following basic financial statements?

a. income statements, a discounted cash flow, and statements of cash flows and retained earnings
b. income statements, a statement of cash flows and retained earnings, and a balance sheet
c. a discounted cash flow and a statement of cash flows and retained earnings

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d. income statements and a statement of cash flows and retained earnings

ANSWER: b

81. Why are annual reports important to finance professionals and investors?
   a. that it They are used by investors and finance professionals when they form expectations about the firm's future earnings and dividends, and the riskiness of those cash flows.
   b. Annual reports are skewed in favour of management and thus are not important to finance professionals and investors.
   c. They Annual reports are important only to management because investors rely on the recommendation of financial analysts who are generally skeptical of management reports.
   d. All of the above are reasons that annual reports are important.

ANSWER: a

82. Consider the balance sheet of Wilkes Industries as shown below. Wilkes has $1,000,000 in common stocks and retained earnings. As a result we can state which of the following regarding Wilkes?

Cash	$ 50,000	Accounts payable	$ 100,000
Inventory	200,000	Accruals	100,000
Accounts receivable	250,000	Total CL	$ 200,000
Total CA	$ 500,000	Debt	200,000
Net fixed assets	$ 900,000	Common stock	200,000
		Retained earnings	800,000
Total assets	$1,400,000	Total L & E	$1,400,000

   a. that it 80% of Wilkes shareholder equity comes from issuing more stock.
   b. 20% of Wilkes shareholder equity comes from accumulated profitable earnings of prior years operations.
   c. They 80% of Wilkes shareholder equity comes from accumulated profitable earnings of prior years operations.
   d. Wilkes Industries has had consistently unprofitable operations as indicated by the low common equity relative to its retained earnings.

ANSWER: c

83. According to the fundamental equation of accounting, total assets should equal which of the following?
   a. that it long-term debts and shareholders' equity

b. total liabilities and shareholders' equity
c. they ending cash and shareholders' equity.
d. cash flow investing and cash flow financing.

ANSWER: b

84. Net income available to shareholders excludes which of the following?
a. that it revenues
b. total expenses
c. they income taxes and preferred dividends
d. common dividends

ANSWER: d

85. A firm reports Net After-Tax Income of $250,000. Its board of directors declared preferred dividends of $35,000. If the firm has 90,000 common shareholders, what would be the firm's EPS for the fiscal year?
a. that it $2.39
b. $2.50
c. They $0.35
d. $2.85

ANSWER: a

86. To estimate a firm's cash flow from operations, depreciation is added back to net income. Which of the following is true regarding depreciation?
a. that it Depreciation is an extraordinary expense that is not always deducted when calculating net income and this must be added to net income when calculating a firm's cash flow.
b. Depreciation is not an expense used in calculating net income and thus it must be added back to net income when calculating cash flow.
c. They Depreciation is a noncash charge resulting from the purchase of fixed assets, and is thus added to net income when determining a firm's cash flow.
d. Only amortization is added back to before-tax income when determining a firm's cash flow.

ANSWER: c

87. Which of the following is correct regarding the payment of dividends by a corporation?
a. that it Dividends are tax deductible by the corporation once they have been declared.
b. Dividends are paid out of net after-tax income and thus are tax deductible by the corporation in the following tax year.
c. They Dividends are paid out of net after-tax income and thus are not tax deductible by the corporation.
d. If dividends are paid after-tax bond interest they are tax deductible by the corporation.

ANSWER: c

88. Which of the following reporting standards are generally used by Canadian firms when reporting their financial results?
a. that it Generally Accepted International Standards (GAIS)
b. International Financial Reporting Standards (IFRS)
c. They Generally Accepted Accounting Standards (GAAP)

d. ISO 9000 Standards

ANSWER: b

89. Which of the following are **NOT** included in calculating total investor supplied capital?

a. that it notes payable
b. preferred and common equity
c. they long-term bonds
d. accounts payable

ANSWER: d

90. Which of the following is **NOT** considered a "good" use of free cash flow?

a. that it pay interest to bond holders
b. payment down bond principal
c. they pay dividends
d. payment of senior management bonuses

ANSWER: d

91. CAD Corp Inc. reported $15,000 of sales and $6,000 of operating costs (including depreciation). The company had $18,750 of investor-supplied operating assets (or capital), the weighted average cost of that capital (the WACC) was 9.5%, and the combined federal and provincial income tax rate was 40%. How much value did management add to shareholders' wealth during the year?

a. $4,500
b. $6,000
c. $3,150
d. $1,500

ANSWER: c

92. Saskatchewan Corporation has the following balance sheet. How much net operating working capital does the firm have?

Cash	$ 20	Accounts payable	$ 40
Short-term investments	30	Accruals	20
Accounts receivable	70	Notes payable	60
Inventory	40	Current liabilities	$ 120
Current assets	$160	Long-term debt	0
Net fixed assets	100	Common equity	90
Retained earnings	50		
Total assets	$260	Total liab. & equity	$260

a. $75
b. $70
c. $130
d. $70

ANSWER: b

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