

**Test Bank for Essentials of Corporate Finance 8th Edition by  
Ross Westerfield Jordan ISBN 0078034752 9780078034756**

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**Multiple Choice Questions**

1. Net working capital is defined as:
  - A. the depreciated book value of a firm's fixed assets.
  - B. the value of a firm's current assets.
  - C. available cash minus current liabilities.
  - D. total assets minus total liabilities.
  - E. current assets minus current liabilities.
2. The accounting statement that measures the revenues, expenses, and net income of a firm over a period of time is called the:
  - A. statement of cash flows.
  - B. income statement.
  - C. GAAP statement.
  - D. balance sheet.
  - E. net working capital schedule.
3. The financial statement that summarizes a firm's accounting value as of a particular date is called the:
  - A. income statement.
  - B. cash flow statement.
  - C. liquidity position.
  - D. balance sheet.
  - E. periodic operating statement.
4. Which one of the following decreases net income but does not affect the operating cash flow of a firm that owes no taxes for the current year?
  - A. Indirect cost
  - B. Direct cost
  - C. Noncash item

- D. Period cost
- E. Variable cost

5. Which one of the following terms is defined as the total tax paid divided by the total taxable income?
- A. Average tax rate
  - B. Variable tax rate
  - C. Marginal tax rate
  - D. Absolute tax rate
  - E. Contingent tax rate
6. Which one of the following is the tax rate that applies to the next dollar of taxable income that a firm earns?
- A. Average tax rate
  - B. Variable tax rate
  - C. Marginal tax rate
  - D. Absolute tax rate
  - E. Contingent tax rate
7. Cash flow from assets is defined as:
- A. the cash flow to shareholders minus the cash flow to creditors.
  - B. operating cash flow plus the cash flow to creditors plus the cash flow to shareholders.
  - C. operating cash flow minus the change in net working capital minus net capital spending.
  - D. operating cash flow plus net capital spending plus the change in net working capital.
  - E. cash flow to shareholders minus net capital spending plus the change in net working capital.
8. Operating cash flow is defined as:
- A. a firm's net profit over a specified period of time.
  - B. the cash that a firm generates from its normal business activities.
  - C. a firm's operating margin.
  - D. the change in the net working capital over a stated period of time.
  - E. the cash that is generated and added to retained earnings.
9. Which one of the following has nearly the same meaning as free cash flow?
- A. Net income
  - B. Cash flow from assets
  - C. Operating cash flow
  - D. Cash flow to shareholders
  - E. Addition to retained earnings

10. Cash flow to creditors is defined as:
- A. interest paid minus net new borrowing.
  - B. interest paid plus net new borrowing.
  - C. the operating cash flow minus net capital spending minus change in net working capital.
  - D. dividends paid plus net new borrowing.
  - E. cash flow from assets plus net new equity.
11. Cash flow to stockholders is defined as:
- A. cash flow from assets plus cash flow to creditors.
  - B. operating cash flow minus cash flow to creditors.
  - C. dividends paid plus the change in retained earnings.
  - D. dividends paid minus net new equity raised.
  - E. net income minus the addition to retained earnings.
12. Which one of the following is an intangible fixed asset?
- A. Inventory
  - B. Machinery
  - C. Copyright
  - D. Account receivable
  - E. Building
13. Delivery trucks are classified as:
- A. noncash expenses.
  - B. current liabilities.
  - C. current assets.
  - D. tangible fixed assets.
  - E. intangible fixed assets.
14. Which one of the following is included in net working capital?
- A. Land
  - B. Accounts payable
  - C. Equipment
  - D. Depreciation
  - E. Dividend

15. Over the past year, a firm decreased its current assets and increased its current liabilities. As a result, the firm's net working capital:
- A. had to increase.
  - B. had to decrease.
  - C. could have remained constant if the amount of the decrease in current assets equaled the amount of the increase in current liabilities.
  - D. could have either increased, decreased, or remained constant.
  - E. was unaffected as the changes occurred in the firm's current accounts.
16. Which one of the following is included in net working capital?
- A. Newly purchased equipment with a useful life of 6 years
  - B. Mortgage on a building payable over the next 12 years
  - C. Interest on a long-term debt
  - D. 10-year bonds issued to the general public
  - E. Invoice from a supplier for inventory purchased
17. Shareholders' equity is equal to:
- A. total assets plus total liabilities.
  - B. net fixed assets minus total liabilities.
  - C. net fixed assets minus long-term debt plus net working capital.
  - D. net working capital plus total assets.
  - E. total assets minus net working capital.
18. Which one of the following is an equity account?
- A. Paid-in surplus
  - B. Bonds payable
  - C. Patent
  - D. Depreciation
  - E. Net fixed assets
19. Which one of the following statements is correct?
- A. Shareholders' equity is the residual value of a firm.
  - B. Net working capital must be a positive value.
  - C. An increase in cash reduces the liquidity of a firm.
  - D. Equipment is generally considered a highly liquid asset.
  - E. Depreciation increases total assets.

20. All else equal, an increase in which one of the following will decrease owners' equity?

- A. Increase in inventory
- B. Increase in accounts payable
- C. Increase in accounts receivable
- D. Increase in net working capital
- E. Increase in net fixed assets

21. Which one of the following will decrease the net working capital of a firm?

- A. Obtaining a three-year loan and using the proceeds to buy inventory
- B. Collecting a payment from a credit customer
- C. Obtaining a five-year loan to buy equipment
- D. Selling inventory at a profit
- E. Making a payment on a long-term debt

22. Which one of the following will decrease the liquidity level of a firm?

- A. Cash purchase of inventory
- B. Credit sale of inventory
- C. Cash sale of inventory
- D. Collection of an account receivable
- E. Proceeds from a long-term loan

23. Highly liquid assets:

- A. increase the probability a firm will face financial distress.
- B. appear on the right side of a balance sheet.
- C. generally produce a high rate of return.
- D. can be sold quickly at close to full value.
- E. include all intangible assets.

24. Financial leverage:

- A. increases as the net working capital increases.
- B. is equal to the market value of a firm divided by the firm's book value.
- C. is inversely related to the level of debt.
- D. is the ratio of a firm's revenues to its fixed expenses.
- E. increases the potential return to the shareholders.

25. Which one of the following statements concerning market and book values is correct?
- A. The market value of accounts receivable is generally higher than the book value of those receivables.
  - B. The market value tends to provide a better guide to the actual worth of an asset than does the book value.
  - C. The market value of fixed assets will always exceed the book value of those assets.
  - D. Book values represent the amount of cash that will be received if an asset is sold.
  - E. The current book value of equipment purchased last year is equal to the initial cost of the equipment.
26. Which one of the following is included in the market value of a firm but not in the book value?
- A. Raw materials
  - B. Partially built inventory
  - C. Tax liability
  - D. Reputation of the firm
  - E. Value of a partially depreciated machine
27. The market value of a firm's fixed assets:
- A. must exceed the book value of those assets.
  - B. is more predictable than the book value of those assets.
  - C. in addition to the firm's net working capital reflects the true value of a firm.
  - D. is decreased annually by the depreciation expense.
  - E. is equal to the estimated current cash value of those assets.
28. Which one of the following statements is correct concerning a firm's fixed assets?
- A. The market value is the expected selling price in today's economy.
  - B. The market value is affected by the accounting method selected.
  - C. The market value is equal to the initial cost minus the depreciation to date.
  - D. The book value is equal to the market value minus the accumulated depreciation.
  - E. The book value is the greater of the initial cost or the current market value.
29. Which one of the following statements concerning the balance sheet is correct?
- A. Total assets equal total liabilities minus total equity.
  - B. Net working capital is equal total assets minus total liabilities.
  - C. Assets are listed in descending order of liquidity.
  - D. Current assets are equal to total assets minus net working capital.
  - E. Shareholders' equity is equal to net working capital minus net fixed assets plus long-term debt.

30. An income statement prepared according to GAAP:
- A. reflects the net cash flows of a firm over a stated period of time.
  - B. reflects the financial position of a firm as of a particular date.
  - C. distinguishes variable costs from fixed costs.
  - D. records revenue when payment for a sale is received.
  - E. records expenses based on the matching principle.
31. An increase in which one of the following will increase net income?
- A. Fixed costs
  - B. Depreciation
  - C. Marginal tax rate
  - D. Revenue
  - E. Dividends
32. Which two of the following determine when revenue is recorded on the financial statements based on the recognition principle?
- I. Payment is collected for the sale of a good or service.
  - II. The earnings process is virtually complete.
  - III. The value of a sale can be reliably determined.
  - IV. The product is physically delivered to the buyer.
- A. I and II only
  - B. I and IV only
  - C. II and III only
  - D. II and IV only
  - E. I and III only
33. Depreciation does which one of the following for a profitable firm?
- A. Increases net income
  - B. Increases net fixed assets
  - C. Decreases net working capital
  - D. Lowers taxes
  - E. Has no effect on net income



34. The recognition principle states that:
- A. costs should be recorded on the income statement whenever those costs can be reliably determined.
  - B. costs should be recorded when paid.
  - C. the costs of producing an item should be recorded when the sale of that item is recorded as revenue.
  - D. sales should be recorded when the payment for that sale is received.
  - E. sales should be recorded when the earnings process is virtually completed and the value of the sale can be determined.
35. The matching principle states that:
- A. costs should be recorded on the income statement whenever those costs can be reliably determined.
  - B. costs should be recorded when paid.
  - C. the costs of producing an item should be recorded when the sale of that item is recorded as revenue.
  - D. sales should be recorded when the payment for that sale is received.
  - E. sales should be recorded when the earnings process is virtually completed and the value of the sale can be determined.
36. Which one of the following statements related to the income statement is correct?
- A. Depreciation has no effect on taxes.
  - B. Interest paid is a noncash item.
  - C. Taxable income must be a positive value.
  - D. Net income is distributed either to dividends or retained earnings.
  - E. Taxable income plus interest and depreciation equals earnings before interest and taxes.
37. Firms that compile financial statements according to GAAP:
- A. record income and expenses at the time they affect the firm's cash flows.
  - B. have no discretion over the timing of recording either revenue or expense items.
  - C. must record all expenses when incurred.
  - D. can still manipulate their earnings to some degree.
  - E. record both income and expenses as soon as the amount for each can be ascertained.
38. The concept of marginal taxation is best exemplified by which one of the following?
- A. Kirby's paid \$120,000 in taxes while its primary competitor paid only \$80,000 in taxes.
  - B. Johnson's Retreat paid only \$45,000 on total revenue of \$570,000 last year.
  - C. Mitchell's Grocer increased its sales by \$52,000 last year and had to pay an additional \$16,000 in taxes.
  - D. Burlington Centre paid no taxes last year due to carryforward losses.
  - E. The Blue Moon paid \$2.20 in taxes for every \$10 of revenue last year.

39. The corporate tax structure in the U.S. is based on a:
- A. maximum tax rate of 38 percent.
  - B. minimum tax rate of 10 percent.
  - C. flat rate of 34 percent for the highest income earners.
  - D. flat-rate tax.
  - E. modified flat-rate tax.
40. Which one of the following will increase the cash flow from assets for a tax-paying firm, all else constant?
- A. An increase in net capital spending
  - B. A decrease in the cash flow to creditors
  - C. An increase in depreciation
  - D. An increase in the change in net working capital
  - E. A decrease in dividends paid
41. A negative cash flow to stockholders indicates a firm:
- A. had a negative cash flow from assets.
  - B. had a positive cash flow to creditors.
  - C. paid dividends that exceeded the amount of the net new equity.
  - D. repurchased more shares than it sold.
  - E. received more from selling stock than it paid out to shareholders.
42. If a firm has a negative cash flow from assets every year for several years, the firm:
- A. may be continually increasing in size.
  - B. must also have a negative cash flow from operations each year.
  - C. is operating at a high level of efficiency.
  - D. is repaying debt every year.
  - E. has annual net losses.
43. An increase in which one of the following will increase operating cash flow for a profitable, tax-paying firm?
- A. Fixed expenses
  - B. Interest paid
  - C. Net capital spending
  - D. Inventory
  - E. Depreciation

44. Tressler Industries opted to repurchase 5,000 shares of stock last year in lieu of paying a dividend. The cash flow statement for last year must have which one of the following assuming that no new shares were issued?
- A. Positive operating cash flow
  - B. Negative cash flow from assets
  - C. Negative cash flow to stockholders
  - D. Negative operating cash flow
  - E. Positive cash flow to stockholders
45. Net capital spending is equal to:
- A. ending net fixed assets minus beginning net fixed assets plus depreciation.
  - B. beginning net fixed assets minus ending net fixed assets plus depreciation.
  - C. ending net fixed assets minus beginning net fixed assets minus depreciation.
  - D. ending total assets minus beginning total assets plus depreciation.
  - E. ending total assets minus beginning total assets minus depreciation.
46. Which one of the following relates to a negative change in net working capital?
- A. Increase in the inventory level
  - B. Sale of net fixed assets
  - C. Purchase of net fixed assets
  - D. Increase in current assets and decrease in current liabilities for the period
  - E. Increase in current liabilities with no change in current assets for the period
47. Which one of the following will increase cash flow from assets but not affect the operating cash flow?
- A. Increase in depreciation
  - B. Increase in accounts receivable
  - C. Sale of a fixed asset
  - D. Decrease in cost of goods sold
  - E. Increase in sales
48. Cash flow to creditors is equal to:
- A. cash flow from assets plus cash flow to stockholders.
  - B. beginning total liabilities minus ending total liabilities plus interest paid.
  - C. beginning long-term debt minus ending long-term debt plus interest paid.
  - D. ending total debt minus beginning total debt plus interest paid.
  - E. ending long-term debt minus beginning long-term debt plus interest paid.

49. Which one of the following indicates that a firm has generated sufficient internal cash flow to finance its entire operations for the period?
- A. Positive operating cash flow
  - B. Negative cash flow to creditors
  - C. Positive cash flow to stockholders
  - D. Negative net capital spending
  - E. Positive cash flow from assets
50. Kroeger Exporters has total assets of \$74,300, net working capital of \$22,900, owners' equity of \$38,600, and long-term debt of \$23,900. What is the value of the current assets?
- A. \$21,600
  - B. \$24,300
  - C. \$38,900
  - D. \$34,700
  - E. \$46,100
51. Morgantown Movers has net working capital of \$11,300, current assets of \$31,200, equity of \$53,400, and long-term debt of \$11,600. What is the amount of the net fixed assets?
- A. \$31,800
  - B. \$32,900
  - C. \$45,500
  - D. \$48,100
  - E. \$53,700
52. The Draiman, Inc. currently has \$3,600 in cash. The company owes \$41,800 to suppliers for merchandise and \$21,500 to the bank for a long-term loan. Customers owe The Draiman \$18,000 for their purchases. The inventory has a book value of \$53,300 and an estimated market value of \$61,200. If the store compiled a balance sheet as of today, what would be the book value of the current assets?
- A. \$46,800
  - B. \$55,600
  - C. \$64,700
  - D. \$74,900
  - E. \$96,500
53. Donut Delite has total assets of \$31,300, long-term debt of \$8,600, net fixed assets of \$19,300, and owners' equity of \$21,100. What is the value of the net working capital?
- A. \$9,800
  - B. \$10,400
  - C. \$18,900
  - D. \$21,300
  - E. \$23,200

54. Early Works had \$87,600 in net fixed assets at the beginning of the year. During the year, the company purchased \$6,400 in new equipment. It also sold, at a price of \$2,300, some old equipment with a book value of \$1,100. The depreciation expense for the year was \$3,700. What is the net fixed asset balance at the end of the year?
- A. \$76,400
  - B. \$78,800
  - C. \$80,000
  - D. \$87,200
  - E. \$89,400
55. Plato's Foods has ending net fixed assets of \$84,400 and beginning net fixed assets of \$79,900. During the year, the firm sold assets with a total book value of \$13,600 and also recorded \$14,800 in depreciation expense. How much did the company spend to buy new fixed assets?
- A. -\$23,900
  - B. \$3,300
  - C. \$32,900
  - D. \$36,800
  - E. \$37,400
56. Red Roofs, Inc. has current liabilities of \$24,300 and accounts receivable of \$7,800. The firm has total assets of \$43,100 and net fixed assets of \$23,700. The owners' equity has a book value of \$21,400. What is the amount of the net working capital?
- A. \$5,100
  - B. -\$4,900
  - C. \$6,500
  - D. \$18,800
  - E. -\$2,600
57. Pete's Warehouse has net working capital of \$2,400, total assets of \$19,300, and net fixed assets of \$10,200. What is the value of the current liabilities?
- A. -\$6,700
  - B. -\$2,900
  - C. \$2,900
  - D. \$6,700
  - E. \$11,500

58. Baugh and Essary reports the following account balances: inventory of \$17,600, equipment of \$128,300, accounts payable of \$24,700, cash of \$11,900, and accounts receivable of \$31,900. What is the amount of the current assets?
- A. \$46,700
  - B. \$56,000
  - C. \$61,400
  - D. \$175,000
  - E. \$199,700
59. Donner United has total owners' equity of \$18,800. The firm has current assets of \$23,100, current liabilities of \$12,200, and total assets of \$36,400. What is the value of the long-term debt?
- A. \$5,400
  - B. \$12,500
  - C. \$13,700
  - D. \$29,800
  - E. \$43,000
60. The Braxton Co. has beginning long-term debt of \$64,500, which is the principal balance of a loan payable to Centre Bank. During the year, the company paid a total of \$16,300 to the bank, including \$4,100 of interest. The company also borrowed \$11,000. What is the value of the ending long-term debt?
- A. \$45,100
  - B. \$53,300
  - C. \$58,200
  - D. \$63,300
  - E. \$85,900
61. The Toy Store has beginning retained earnings of \$28,975. For the year, the company earned net income of \$4,680 and paid dividends of \$1,600. The company also issued \$3,000 worth of new stock. What is the value of the retained earnings account at the end of the year?
- A. \$20,445
  - B. \$22,695
  - C. \$27,375
  - D. \$32,055
  - E. \$35,255

62. Leslie Printing has net income of \$26,310 for the year. At the beginning of the year, the firm had common stock of \$55,000, paid-in surplus of \$11,200, and retained earnings of \$48,420. At the end of the year, the firm had total equity of \$142,430. The firm does not pay dividends. What is the amount of the net new equity raised during the year?
- A. \$1,500
  - B. \$2,500
  - C. \$2,700
  - D. \$48,420
  - E. \$48,310
63. The Embroidery Shoppe had beginning retained earnings of \$18,670. During the year, the company reported sales of \$83,490, costs of \$68,407, depreciation of \$8,200, dividends of \$950, and interest paid of \$478. The tax rate is 35 percent. What is the retained earnings balance at the end of the year?
- A. \$21,883.25
  - B. \$22,193.95
  - C. \$22,833.24
  - D. \$23,783.24
  - E. \$30,393.95
64. The owners' equity for The Deer Store was \$58,900 at the beginning of the year. During the year, the company had aftertax income of \$4,200, of which \$3,200 was paid in dividends. Also during the year, the company repurchased \$6,500 of stock from one of the shareholders. What is the value of the owners' equity at year end?
- A. \$53,400
  - B. \$45,000
  - C. \$59,900
  - D. \$84,400
  - E. \$90,900
65. Gino's Winery has net working capital of \$29,800, net fixed assets of \$64,800, current liabilities of \$34,700, and long-term debt of \$23,000. What is the value of the owners' equity?
- A. \$36,900
  - B. \$66,700
  - C. \$71,600
  - D. \$89,400
  - E. \$106,300

66. The Pier Import Store has cash of \$34,600 and accounts receivable of \$54,200. The inventory cost \$92,300 and can be sold today for \$146,900. The fixed assets were purchased at a cost of \$234,500 of which \$107,900 has been depreciated. The fixed assets can be sold today for \$199,000. What is the total book value of the firm's assets?
- A. \$127,800  
 B. \$307,700  
 C. \$346,800  
 D. \$382,300  
 E. \$415,600
67. Lester's Fried Chick'n purchased its building 11 years ago at a cost of \$139,000. The building is currently valued at \$179,000. The firm has other fixed assets that cost \$66,000 and are currently valued at \$58,000. To date, the firm has recorded a total of \$79,000 in depreciation on the various assets. The company has current liabilities of \$36,600 and net working capital of \$18,400. What is the total book value of the firm's assets?
- A. \$181,000  
 B. \$241,000  
 C. \$331,000  
 D. \$339,000  
 E. \$379,000
68. The financial statements of Jame's Auto Repair reflect cash of \$14,600, accounts receivable of \$11,500, accounts payable of \$22,900, inventory of \$17,800, long-term debt of \$42,000, and net fixed assets of \$63,800. The firm estimates that if it wanted to cease operations today it could sell the inventory for \$35,000 and the fixed assets for \$49,000. The firm could also collect 100 percent of its receivables. What is the market value of the assets?
- A. \$32,800  
 B. \$39,900  
 C. \$74,000  
 D. \$95,500  
 E. \$110,100
69. The Good Life Store has sales of \$79,600. The cost of goods sold is \$48,200 and the other costs are \$18,700. Depreciation is \$8,300 and the tax rate is 34 percent. What is the net income?
- A. \$2,904  
 B. \$8,382  
 C. \$11,204  
 D. \$14,660  
 E. \$16,682



70. Chevelle, Inc. has sales of \$487,000 and costs of \$394,500. The depreciation expense is \$43,800. Interest paid equals \$18,200 and dividends paid equal \$6,500. The tax rate is 35 percent. What is the addition to retained earnings?
- A. \$10,775
  - B. \$11,460
  - C. \$13,120
  - D. \$13,325
  - E. \$15,450
71. Last year, The Pizza Joint added \$4,100 to retained earnings from sales of \$93,600. The company had costs of \$74,400, dividends of \$2,500, and interest paid of \$1,400. The tax rate was 34 percent. What was the amount of the depreciation expense?
- A. \$7,300
  - B. \$7,500
  - C. \$7,800
  - D. \$8,100
  - E. \$8,400
72. Holly Farms has sales of \$581,600, costs of \$479,700, depreciation expense of \$32,100, and interest paid of \$8,400. The tax rate is 42 percent. How much net income did the firm earn for the period?
- A. \$25,788
  - B. 35,612
  - C. \$43,380
  - D. \$45,671
  - E. \$45,886
73. For the year, Movers United has net income of \$31,800, net new equity of \$7,500, and an addition to retained earnings of \$24,200. What is the amount of the dividends paid?
- A. \$100
  - B. \$7,500
  - C. \$7,600
  - D. \$15,100
  - E. \$16,700

74. ACE, Inc. incurred depreciation expenses of \$21,900 last year. The sales were \$811,400 and the addition to retained earnings was \$14,680. The firm paid interest of \$9,700 and dividends of \$10,100. The tax rate was 40 percent. What was the amount of the costs incurred by the firm?
- A. \$665,200.00
  - B. \$689,407.67
  - C. \$742,306.08
  - D. \$738,500.00
  - E. \$780,400.21
75. Bridgewater Furniture has sales of \$811,000, costs of \$658,000, and interest paid of \$21,800. The depreciation expense is \$56,100 and the tax rate is 34 percent. At the beginning of the year, the firm had retained earnings of \$318,300 and common stock of \$250,000. At the end of the year, the firm has retained earnings of \$322,500 and common stock of \$280,000. What is the amount of the dividends paid for the year?
- A. \$15,266
  - B. \$19,466
  - C. \$31,566
  - D. \$41,066
  - E. \$45,366
76. Bama & Co. owes a total of \$21,684 in taxes for this year. The taxable income is \$61,509. If the firm earns \$100 more in income, it will owe an additional \$56 in taxes. What is the average tax rate on income of \$71,609?
- A. 28.00 percent
  - B. 30.33 percent
  - C. 33.33 percent
  - D. 35.00 percent
  - E. 35.29 percent
77. Paddle Fans & More has a marginal tax rate of 34 percent and an average tax rate of 23.7 percent. If the firm earns \$138,500 in taxable income, how much will it owe in taxes?
- A. \$31,366.67
  - B. \$31,500.00
  - C. \$32,824.50
  - D. \$39,957.25
  - E. \$47,090.00

78. Redneck Farm Equipment owes \$48,329 in tax on a taxable income of \$549,600. The company has determined that it will owe \$56,211 in tax if its taxable income rises to \$565,000. What is the marginal tax rate at this level of income?
- A. 9.95 percent
  - B. 30.00 percent
  - C. 30.67 percent
  - D. 51.03 percent
  - E. 51.18 percent

79. Use the following tax table to answer this question:

Taxable Income		Tax Rate
\$ 0-	50,000	15%
50,001-	75,000	25
75,001-	100,000	34
100,001-	335,000	39
335,001-	10,000,000	34

Bait and Tackle has taxable income of \$411,562. How much does it owe in taxes?

- A. \$128,603.33
- B. \$134,611.27
- C. \$138,542.79
- D. \$139,931.08
- E. \$141,354.82

80. Use the following tax table to answer this question:

Taxable Income		Tax Rate
\$ 0-	50,000	15%
50,001-	75,000	25
75,001-	100,000	34
100,001-	335,000	39
335,001-	10,000,000	34

The Holiday Inn earned \$177,284 in taxable income for the year. How much tax does the company owe on this income?

- A. \$46,311.02
- B. \$48,490.76
- C. \$52,390.76
- D. \$59,998.81
- E. \$65,240.76

81. The Plaza Cafe has an operating cash flow of \$78,460, depreciation expense of \$8,960, and taxes paid of \$21,590. A partial listing of its balance sheet accounts is as follows:

	Beginning Balance	Ending Balance
Current assets	\$141,680	\$138,509
Net fixed assets	\$687,810	\$703,411
Current liabilities	\$ 87,340	\$ 91,516
Long-term debt	\$267,000	\$248,000

What is the amount of the cash flow from assets?

- A. \$58,913  
 B. \$61,246  
 C. \$61,487  
 D. \$63,909  
 E. \$64,128
82. Miser Materials paid \$27,500 in dividends and \$28,311 in interest over the past year while net working capital increased from \$13,506 to \$18,219. The company purchased \$42,000 in net new fixed assets and had depreciation expenses of \$16,805. During the year, the firm issued \$25,000 in net new equity and paid off \$21,000 in long-term debt. What is the amount of the cash flow from assets?
- A. \$21,811  
 B. \$30,811  
 C. \$36,189  
 D. \$49,811  
 E. 51,811
83. The Pretzel Factory has net sales of \$821,300 and costs of \$698,500. The depreciation expense is \$28,400 and the interest paid is \$8,400. What is the amount of the firm's operating cash flow if the tax rate is 34 percent?
- A. \$87,620  
 B. \$89,540  
 C. \$91,220  
 D. \$93,560  
 E. \$95,240

84. The Paint Ball Range, Inc. paid \$30,500 in dividends and \$7,600 in interest over the past year. Sales totaled \$211,800 with costs of \$167,900. The depreciation expense was \$16,500. The applicable tax rate is 34 percent. What is the amount of the operating cash flow?
- A. \$14,232
  - B. \$15,306
  - C. \$28,222
  - D. \$37,168
  - E. \$40,568
85. The balance sheet of a firm shows beginning net fixed assets of \$348,200 and ending net fixed assets of \$371,920. The depreciation expense for the year is \$46,080 and the interest expense is \$11,460. What is the amount of the net capital spending?
- A. -\$22,360
  - B. -\$4,780
  - C. \$23,720
  - D. \$58,340
  - E. \$69,800
86. The financial statements of Backwater Marina reflect depreciation expenses of \$41,600 and interest expenses of \$27,900 for the year. The current assets increased by \$31,800 and the net fixed assets increased by \$28,600. What is the amount of the net capital spending for the year?
- A. \$7,000
  - B. \$21,600
  - C. \$28,600
  - D. \$60,400
  - E. \$70,200
87. Andre's Dog House had current assets of \$67,200 and current liabilities of \$71,100 last year. This year, the current assets are \$82,600 and the current liabilities are \$85,100. The depreciation expense for the past year is \$9,600 and the interest paid is \$8,700. What is the amount of the change in net working capital?
- A. -\$2,800
  - B. -\$1,400
  - C. \$1,400
  - D. \$2,100
  - E. \$2,800

88. The balance sheet of Binger, Inc. has the following balances:

	Beginning balance	Ending balance
Cash	\$21,400	\$16,800
Accounts receivable	47,400	52,300
Inventory	83,800	77,400
Net fixed assets	211,600	203,800
Accounts payable	54,900	56,900
Long-term debt	170,000	185,000

What is the amount of the change in net working capital?

- A. -\$8,100
  - B. -\$7,400
  - C. \$7,700
  - D. \$8,000
  - E. \$8,100
89. During the past year, Arther Anderson Services paid \$360,800 in interest along with \$48,000 in dividends. The company issued \$230,000 of stock and \$200,000 of new debt. The company reduced the balance due on the old debt by \$225,000. What is the amount of the cash flow to creditors?
- A. -\$88,200
  - B. \$51,400
  - C. \$161,800
  - D. \$385,800
  - E. \$585,800
90. A firm has earnings before interest and taxes of \$25,380 with a net income of \$14,220. The taxes amounted to \$5,400 for the year. During the year, the firm paid out \$43,800 to pay off existing debt and then later borrowed an additional \$24,000. What is the amount of the cash flow to creditors?
- A. -\$14,040
  - B. \$19,800
  - C. \$25,560
  - D. \$28,440
  - E. \$29,790

91. The balance sheet of a firm shows current liabilities of \$56,300 and long-term debt of \$289,200 as of last year. Current liabilities are \$76,900 and long-term debt is \$248,750 as of today, which is the end of the current year. The financial statements for the current year reflect an interest paid amount of \$29,700 and dividends of \$19,000. What is the amount of the net new borrowing?
- A. -\$40,450
  - B. \$40,450
  - C. \$64,750
  - D. \$70,150
  - E. \$78,250
92. For the past year, LP Gas, Inc. had cash flow from assets of \$38,100 of which \$21,500 flowed to the firm's stockholders. The interest paid was \$2,300. What is the amount of the net new borrowing?
- A. -\$14,300
  - B. -\$9,700
  - C. \$12,300
  - D. \$14,300
  - E. \$18,900
93. Six months ago, Benders Gym repurchased \$20,000 of its common stock. The company pays regular quarterly dividends totaling \$8,500 per quarter. What is the amount of the cash flow to stockholders for the past year if no additional shares were issued?
- A. -\$10,000
  - B. \$20,000
  - C. \$28,500
  - D. \$30,000
  - E. \$54,000
94. The Underground Cafe has an operating cash flow of \$187,000 and a cash flow to creditors of \$71,400 for the past year. During that time, the firm invested \$28,000 in net working capital and incurred net capital spending of \$47,900. What is the amount of the cash flow to stockholders for the last year?
- A. -\$171,500
  - B. -\$86,700
  - C. \$21,200
  - D. \$39,700
  - E. \$111,100

95. The Brown Jug has compiled the following information:

	<u>2013</u>	<u>2014</u>
Sales	\$312,400	\$198,500
Interest paid	18,720	16,480
Long-term debt	225,000	187,000
Owners' equity	134,600	128,700
Depreciation	21,600	20,200
Accounts receivable	15,600	18,900
Other costs	32,400	27,100
Inventory	36,800	32,800
Accounts payable	12,800	21,900
Cost of goods sold	186,200	128,300
Cash	36,500	12,700
Taxes	18,200	1,000

What is the operating cash flow for 2014?

- A. \$21,900
- B. \$26,700
- C. \$42,100
- D. \$48,300
- E. \$52,600



96. Home Supply, Inc. has compiled the following information:

	<u>2013</u>	<u>2014</u>
Sales	\$427,400	\$511,500
Interest paid	19,800	21,600
Long-term debt	260,000	295,000
Common stock	150,000	160,000
Depreciation	24,600	23,500
Accounts receivable	38,200	34,900
Other costs	58,400	61,100
Inventory	58,800	56,800
Accounts payable	36,800	32,900
Cost of goods sold	274,200	289,300
Cash	41,500	36,700
Taxes	11,400	39,400
Net fixed assets	336,900	392,200
Retained earnings	28,600	32,700

For 2014, the cash flow from assets is \_\_\_\_\_ and the cash flow to shareholders is \_\_\_\_\_.

- A. \$49,100; \$62,500
- B. \$49,100; \$76,800
- C. \$49,100; \$81,100
- D. \$56,400; \$76,800
- E. \$56,400; \$79,300

97. The Carpentry Shop has sales of \$398,600, costs of \$254,800, depreciation expense of \$26,400, interest expense of \$1,600, and a tax rate of 34 percent. What is the net income for this firm?

- A. \$61,930
- B. \$66,211
- C. \$67,516
- D. \$76,428
- E. \$83,219

98. Andersen's Nursery has sales of \$318,400, costs of \$199,400, depreciation expense of \$28,600, interest expense of \$1,100, and a tax rate of 34 percent. The firm paid out \$16,500 in dividends. What is the addition to retained earnings?

- A. \$36,909
- B. \$42,438
- C. \$44,141
- D. \$47,208
- E. \$47,615

99. Roscoe's purchased new machinery three years ago for \$1.8 million. The machinery can be sold to Stewart's today for \$1.2 million. Roscoe's current balance sheet shows net fixed assets of \$960,000, current liabilities of \$348,000, and net working capital of \$121,000. If all the current assets were liquidated today, the company would receive \$518,000 cash. The book value of the firm's assets today is \_\_\_\_\_ and the market value is \_\_\_\_\_.
- A. \$1,081,000; \$1,308,000
  - B. \$1,081,000; \$1,718,000
  - C. \$1,307,000; \$1,429,000
  - D. \$1,429,000; \$1,308,000
  - E. \$1,429,000; \$1,718,000
100. Daniel's Market has sales of \$36,600, costs of \$28,400, depreciation expense of \$3,100, and interest expense of \$1,500. If the tax rate is 34 percent, what is the operating cash flow, OCF?
- A. \$4,811
  - B. \$5,279
  - C. \$6,466
  - D. \$6,976
  - E. \$7,013
101. The Play House's December 31, 2013, balance sheet showed net fixed assets of \$1,238,000 and the December 31, 2014, balance sheet showed net fixed assets of \$1,416,000. The company's 2014 income statement showed a depreciation expense of \$214,600. What was the firm's net capital spending for 2014?
- A. \$36,600
  - B. \$42,400
  - C. \$392,600
  - D. \$404,400
  - E. \$416,600
102. The December 31, 2013, balance sheet of Suzette's Market showed long-term debt of \$638,100 and the December 31, 2014, balance sheet showed long-term debt of \$574,600. The 2010 income statement showed an interest expense of \$42,300. What was the firm's cash flow to creditors during 2014?
- A. \$21,200
  - B. \$26,700
  - C. \$54,900
  - D. \$102,400
  - E. \$105,800

103. Gorman Distributors shows the following information on its 2014 income statement: sales = \$317,800; costs = \$211,400; other expenses = \$18,500; depreciation expense = \$31,200; interest expense = \$2,100; taxes = \$18,600; dividends = \$12,000. In addition, you're told that the firm issued \$4,500 in new equity during 2014, and redeemed \$6,500 in outstanding long-term debt. If net fixed assets increased by \$7,400 during the year, what was the addition to net working capital?

- A. \$17,900
- B. \$14,600
- C. \$15,800
- D. \$16,200
- E. \$17,400

104. Able Co. has \$218,000 in taxable income and Bravo Co. has \$5,600,000 in taxable income. Suppose both firms have identified a new project that will increase taxable income by \$12,000. The additional project will increase Able Co.'s taxes by \_\_\_\_\_ and Bravo Co.'s taxes by \_\_\_\_\_.

Taxable Income		Tax Rate
\$ 0-	50,000	15%
50,001-	75,000	25
75,001-	100,000	34
100,001-	335,000	39
335,001-	10,000,000	34

- A. \$1,800; \$1,800
- B. \$4,080; \$4,080
- C. \$4,080; \$4,680
- D. \$4,680; \$4,080
- E. \$4,680; \$4,680

105. During the year, The Dalton Firm had sales of \$3,210,000. Cost of goods sold, administrative and selling expenses, and depreciation expenses were \$2,540,000, \$389,000, and \$112,000, respectively. In addition, the company had an interest expense of \$118,000 and a tax rate of 34 percent. (Ignore any tax loss carryback or carryforward provisions.) What is its operating cash flow?

- A. \$263,660
- B. \$271,420
- C. \$273,330
- D. \$285,400
- E. \$287,700

106. Precision Manufacturing had the following operating results for 2014: sales = \$38,900; cost of goods sold = \$24,600; depreciation expense = \$1,700; interest expense = \$1,400; dividends paid = \$1,000. At the beginning of the year, net fixed assets were \$14,300, current assets were \$8,700, and current liabilities were \$6,600. At the end of the year, net fixed assets were \$13,900, current assets were \$9,200, and current liabilities were \$7,400. The tax rate for 2014 was 34 percent. What is the cash flow from assets for 2014?

- A. \$8,047
- B. \$8,292
- C. \$8,658
- D. \$9,492
- E. \$9,964

### Essay Questions

107. How can a firm determine if its level of liquidity is appropriate?

108. Which is more important from a finance perspective—net income or operating cash flow? What is the difference between these two values?

109. Explain why the marginal tax rate, rather than the average tax rate, is used when computing the cash flows from a proposed new project.

110. Identify the cash flows that occur between a firm and its shareholders and explain how each of these cash flows affects the cash flow to stockholders.

## Chapter 02 Financial Statements, Taxes, and Cash Flow **Answer Key**

### Multiple Choice Questions

1. Net working capital is defined as:
- A. the depreciated book value of a firm's fixed assets.
  - B. the value of a firm's current assets.
  - C. available cash minus current liabilities.
  - D. total assets minus total liabilities.
  - E. current assets minus current liabilities.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Net working capital*

2. The accounting statement that measures the revenues, expenses, and net income of a firm over a period of time is called the:
- A. statement of cash flows.
  - B. income statement.
  - C. GAAP statement.
  - D. balance sheet.
  - E. net working capital schedule.

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Income statement*

3. The financial statement that summarizes a firm's accounting value as of a particular date is called the:
- A. income statement.
  - B. cash flow statement.
  - C. liquidity position.
  - D. balance sheet.
  - E. periodic operating statement.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Balance sheet*

4. Which one of the following decreases net income but does not affect the operating cash flow of a firm that owes no taxes for the current year?
- A. Indirect cost
  - B. Direct cost
  - C. Noncash item
  - D. Period cost
  - E. Variable cost

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Noncash item*

5. Which one of the following terms is defined as the total tax paid divided by the total taxable income?
- A. Average tax rate
  - B. Variable tax rate
  - C. Marginal tax rate
  - D. Absolute tax rate
  - E. Contingent tax rate

Refer to Section 2.3.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-03 Explain the difference between average and marginal tax rates.*

6. Which one of the following is the tax rate that applies to the next dollar of taxable income that a firm earns?
- A. Average tax rate
  - B. Variable tax rate
  - C. Marginal tax rate
  - D. Absolute tax rate
  - E. Contingent tax rate

Refer to Section 2.3.

AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-03 Explain the difference between average and marginal tax rates.  
Section: 2.3  
Topic: Marginal tax rate

7. Cash flow from assets is defined as:
- A. the cash flow to shareholders minus the cash flow to creditors.
  - B. operating cash flow plus the cash flow to creditors plus the cash flow to shareholders.
  - C. operating cash flow minus the change in net working capital minus net capital spending.
  - D. operating cash flow plus net capital spending plus the change in net working capital.
  - E. cash flow to shareholders minus net capital spending plus the change in net working capital.

Refer to Section 2.4.

AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Cash flow from assets

8. Operating cash flow is defined as:
- A. a firm's net profit over a specified period of time.
  - B. the cash that a firm generates from its normal business activities.
  - C. a firm's operating margin.
  - D. the change in the net working capital over a stated period of time.
  - E. the cash that is generated and added to retained earnings.

Refer to Section 2.4.

AACSB: Analytic  
Blooms: Remember



*Difficulty: 1 Easy*  
*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*  
*Section: 2.4*  
*Topic: Operating cash flow*

9. Which one of the following has nearly the same meaning as free cash flow?
- A. Net income
  - B. Cash flow from assets
  - C. Operating cash flow
  - D. Cash flow to shareholders
  - E. Addition to retained earnings

Refer to Section 2.4.

*AACSB: Analytic*  
*Blooms: Remember*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*  
*Section: 2.4*  
*Topic: Free cash flow*

10. Cash flow to creditors is defined as:
- A. interest paid minus net new borrowing.
  - B. interest paid plus net new borrowing.
  - C. the operating cash flow minus net capital spending minus change in net working capital.
  - D. dividends paid plus net new borrowing.
  - E. cash flow from assets plus net new equity.

Refer to Section 2.4.

*AACSB: Analytic*  
*Blooms: Remember*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*  
*Section: 2.4*  
*Topic: Cash flow to creditors*

11. Cash flow to stockholders is defined as:
- A. cash flow from assets plus cash flow to creditors.
  - B. operating cash flow minus cash flow to creditors.
  - C. dividends paid plus the change in retained earnings.
  - D. dividends paid minus net new equity raised.
  - E. net income minus the addition to retained earnings.

Refer to Section 2.4.

*AACSB: Analytic*  
*Blooms: Remember*  
*Difficulty: 1 Easy*

12. Which one of the following is an intangible fixed asset?

- A. Inventory
- B. Machinery
- C. Copyright
- D. Account receivable
- E. Building

Refer to Section 2.1.

*AACSB: Analytic*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

*Section: 2.1*

*Topic: Intangible fixed assets*

13. Delivery trucks are classified as:

- A. noncash expenses.
- B. current liabilities.
- C. current assets.
- D. tangible fixed assets.
- E. intangible fixed assets.

Refer to Section 2.1.

*AACSB: Analytic*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

*Section: 2.1*

*Topic: Tangible fixed assets*

14. Which one of the following is included in net working capital?

- A. Land
- B. Accounts payable
- C. Equipment
- D. Depreciation
- E. Dividend

Refer to Section 2.1.

*AACSB: Analytic*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

15. Over the past year, a firm decreased its current assets and increased its current liabilities. As a result, the firm's net working capital:
- A. had to increase.
  - B. had to decrease.
  - C. could have remained constant if the amount of the decrease in current assets equaled the amount of the increase in current liabilities.
  - D. could have either increased, decreased, or remained constant.
  - E. was unaffected as the changes occurred in the firm's current accounts.

Refer to Section 2.1.

AACSB: Analytic  
Blooms: Understand  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Net working capital

16. Which one of the following is included in net working capital?
- A. Newly purchased equipment with a useful life of 6 years
  - B. Mortgage on a building payable over the next 12 years
  - C. Interest on a long-term debt
  - D. 10-year bonds issued to the general public
  - E. Invoice from a supplier for inventory purchased

Refer to Section 2.1.

AACSB: Analytic  
Blooms: Understand  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Net working capital

17. Shareholders' equity is equal to:
- A. total assets plus total liabilities.
  - B. net fixed assets minus total liabilities.
  - C. net fixed assets minus long-term debt plus net working capital.
  - D. net working capital plus total assets.
  - E. total assets minus net working capital.

Refer to Section 2.1.

AACSB: Analytic  
Blooms: Understand

*Difficulty: 2 Medium*  
*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*  
*Section: 2.1*  
*Topic: Shareholders' equity*

18. Which one of the following is an equity account?

- A. Paid-in surplus
- B. Bonds payable
- C. Patent
- D. Depreciation
- E. Net fixed assets

Refer to Section 2.1.

*AACSB: Analytic*  
*Blooms: Remember*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*  
*Section: 2.1*  
*Topic: Equity account*

19. Which one of the following statements is correct?

- A. Shareholders' equity is the residual value of a firm.
- B. Net working capital must be a positive value.
- C. An increase in cash reduces the liquidity of a firm.
- D. Equipment is generally considered a highly liquid asset.
- E. Depreciation increases total assets.

Refer to Section 2.1.

*AACSB: Analytic*  
*Blooms: Understand*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*  
*Section: 2.1*  
*Topic: Shareholders' equity*

20. All else equal, an increase in which one of the following will decrease owners' equity?

- A. Increase in inventory
- B. Increase in accounts payable
- C. Increase in accounts receivable
- D. Increase in net working capital
- E. Increase in net fixed assets

Refer to Section 2.1.

*AACSB: Analytic*  
*Blooms: Understand*  
*Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*  
*Section: 2.1*  
*Topic: Owners' equity*

21. Which one of the following will decrease the net working capital of a firm?
- A. Obtaining a three-year loan and using the proceeds to buy inventory
  - B. Collecting a payment from a credit customer
  - C. Obtaining a five-year loan to buy equipment
  - D. Selling inventory at a profit
  - E. Making a payment on a long-term debt

Refer to Section 2.1.

*AACSB: Analytic*  
*Blooms: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*  
*Section: 2.1*  
*Topic: Net working capital*

22. Which one of the following will decrease the liquidity level of a firm?
- A. Cash purchase of inventory
  - B. Credit sale of inventory
  - C. Cash sale of inventory
  - D. Collection of an account receivable
  - E. Proceeds from a long-term loan

Refer to Section 2.1.

*AACSB: Analytic*  
*Blooms: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*  
*Section: 2.1*  
*Topic: Liquidity*

23. Highly liquid assets:
- A. increase the probability a firm will face financial distress.
  - B. appear on the right side of a balance sheet.
  - C. generally produce a high rate of return.
  - D. can be sold quickly at close to full value.
  - E. include all intangible assets.

Refer to Section 2.1.

*AACSB: Analytic*  
*Blooms: Understand*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

24. Financial leverage:

- A. increases as the net working capital increases.
- B. is equal to the market value of a firm divided by the firm's book value.
- C. is inversely related to the level of debt.
- D. is the ratio of a firm's revenues to its fixed expenses.
- E. increases the potential return to the shareholders.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

*Section: 2.1  
Topic: Financial leverage*

25. Which one of the following statements concerning market and book values is correct?

- A. The market value of accounts receivable is generally higher than the book value of those receivables.
- B. The market value tends to provide a better guide to the actual worth of an asset than does the book value.
- C. The market value of fixed assets will always exceed the book value of those assets.
- D. Book values represent the amount of cash that will be received if an asset is sold.
- E. The current book value of equipment purchased last year is equal to the initial cost of the equipment.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

*Section: 2.1  
Topic: Market value*

26. Which one of the following is included in the market value of a firm but not in the book value?

- A. Raw materials
- B. Partially built inventory
- C. Tax liability
- D. Reputation of the firm
- E. Value of a partially depreciated machine

Refer to Section 2.1.

*AACSB: Analytic*

*Blooms: Understand  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Market value*

27. The market value of a firm's fixed assets:
- A. must exceed the book value of those assets.
  - B. is more predictable than the book value of those assets.
  - C. in addition to the firm's net working capital reflects the true value of a firm.
  - D. is decreased annually by the depreciation expense.
  - E. is equal to the estimated current cash value of those assets.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Market value*

28. Which one of the following statements is correct concerning a firm's fixed assets?
- A. The market value is the expected selling price in today's economy.
  - B. The market value is affected by the accounting method selected.
  - C. The market value is equal to the initial cost minus the depreciation to date.
  - D. The book value is equal to the market value minus the accumulated depreciation.
  - E. The book value is the greater of the initial cost or the current market value.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Market and book values*

29. Which one of the following statements concerning the balance sheet is correct?

- A. Total assets equal total liabilities minus total equity.
- B. Net working capital is equal total assets minus total liabilities.
- C. Assets are listed in descending order of liquidity.
- D. Current assets are equal to total assets minus net working capital.
- E. Shareholders' equity is equal to net working capital minus net fixed assets plus long-term debt.

Refer to Section 2.1.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Balance sheet*

30. An income statement prepared according to GAAP:

- A. reflects the net cash flows of a firm over a stated period of time.
- B. reflects the financial position of a firm as of a particular date.
- C. distinguishes variable costs from fixed costs.
- D. records revenue when payment for a sale is received.
- E. records expenses based on the matching principle.

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Income statement*

31. An increase in which one of the following will increase net income?

- A. Fixed costs
- B. Depreciation
- C. Marginal tax rate
- D. Revenue
- E. Dividends

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Net income*



32. Which two of the following determine when revenue is recorded on the financial statements based on the recognition principle?

- I. Payment is collected for the sale of a good or service.
- II. The earnings process is virtually complete.
- III. The value of a sale can be reliably determined.
- IV. The product is physically delivered to the buyer.

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

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Recognition principle*

33. Depreciation does which one of the following for a profitable firm?

- A. Increases net income
- B. Increases net fixed assets
- C. Decreases net working capital
- D. Lowers taxes
- E. Has no effect on net income

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Depreciation*

34. The recognition principle states that:

- A. costs should be recorded on the income statement whenever those costs can be reliably determined.
- B. costs should be recorded when paid.
- C. the costs of producing an item should be recorded when the sale of that item is recorded as revenue.
- D. sales should be recorded when the payment for that sale is received.
- E. sales should be recorded when the earnings process is virtually completed and the value of the sale can be determined.

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Recognition principle*

35. The matching principle states that:

- A. costs should be recorded on the income statement whenever those costs can be reliably determined.
- B. costs should be recorded when paid.
- C. the costs of producing an item should be recorded when the sale of that item is recorded as revenue.
- D. sales should be recorded when the payment for that sale is received.
- E. sales should be recorded when the earnings process is virtually completed and the value of the sale can be determined.

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Matching principle*

36. Which one of the following statements related to the income statement is correct?

- A. Depreciation has no effect on taxes.
- B. Interest paid is a noncash item.
- C. Taxable income must be a positive value.
- D. Net income is distributed either to dividends or retained earnings.
- E. Taxable income plus interest and depreciation equals earnings before interest and taxes.

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy*

*Learning Objective: 02-02 Distinguish accounting income from cashflow.*

*Section: 2.2*

*Topic: Income statement*

37. Firms that compile financial statements according to GAAP:

- A. record income and expenses at the time they affect the firm's cash flows.
- B. have no discretion over the timing of recording either revenue or expense items.
- C. must record all expenses when incurred.
- D. can still manipulate their earnings to some degree.
- E. record both income and expenses as soon as the amount for each can be ascertained.

Refer to Section 2.2.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 1 Easy*

*Learning Objective: 02-02 Distinguish accounting income from cashflow.*

*Section: 2.2*

*Topic: Earnings management*

38. The concept of marginal taxation is best exemplified by which one of the following?

- A. Kirby's paid \$120,000 in taxes while its primary competitor paid only \$80,000 in taxes.
- B. Johnson's Retreat paid only \$45,000 on total revenue of \$570,000 last year.
- C. Mitchell's Grocer increased its sales by \$52,000 last year and had to pay an additional \$16,000 in taxes.
- D. Burlington Centre paid no taxes last year due to carryforward losses.
- E. The Blue Moon paid \$2.20 in taxes for every \$10 of revenue last year.

Refer to Section 2.3.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium*

*Learning Objective: 02-03 Explain the difference between average and marginal tax rates.*

*Section: 2.3*

*Topic: Marginal taxes*

39. The corporate tax structure in the U.S. is based on a:
- A. maximum tax rate of 38 percent.
  - B. minimum tax rate of 10 percent.
  - C. flat rate of 34 percent for the highest income earners.
  - D. flat-rate tax.
  - E. modified flat-rate tax.

Refer to Section 2.3.

*AACSB: Analytic  
Blooms: Remember  
Difficulty: 1 Easy*

*Learning Objective: 02-03 Explain the difference between average and marginal tax rates.*

*Section: 2.3  
Topic: Corporate tax structure*

40. Which one of the following will increase the cash flow from assets for a tax-paying firm, all else constant?
- A. An increase in net capital spending
  - B. A decrease in the cash flow to creditors
  - C. An increase in depreciation
  - D. An increase in the change in net working capital
  - E. A decrease in dividends paid

Refer to Section 2.4.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium*

*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*

*Section: 2.4  
Topic: Cash flow from assets*

41. A negative cash flow to stockholders indicates a firm:
- A. had a negative cash flow from assets.
  - B. had a positive cash flow to creditors.
  - C. paid dividends that exceeded the amount of the net new equity.
  - D. repurchased more shares than it sold.
  - E. received more from selling stock than it paid out to shareholders.

Refer to Section 2.4.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium*

*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*

*Section: 2.4*

42. If a firm has a negative cash flow from assets every year for several years, the firm:

- A. may be continually increasing in size.
- B. must also have a negative cash flow from operations each year.
- C. is operating at a high level of efficiency.
- D. is repaying debt every year.
- E. has annual net losses.

Refer to Section 2.4.

AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4

Topic: Cash flow from assets

43. An increase in which one of the following will increase operating cash flow for a profitable, tax-paying firm?

- A. Fixed expenses
- B. Interest paid
- C. Net capital spending
- D. Inventory
- E. Depreciation

Refer to Section 2.4.

AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4

Topic: Operating cash flow

44. Tressler Industries opted to repurchase 5,000 shares of stock last year in lieu of paying a dividend. The cash flow statement for last year must have which one of the following assuming that no new shares were issued?

- A. Positive operating cash flow
- B. Negative cash flow from assets
- C. Negative cash flow to stockholders
- D. Negative operating cash flow
- E. Positive cash flow to stockholders

Refer to Section 2.4.

AACSB: Analytic  
Blooms: Understand

*Difficulty: 1 Easy*  
*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*  
*Section: 2.4*  
*Topic: Cash flow to stockholders*

45. Net capital spending is equal to:
- A. ending net fixed assets minus beginning net fixed assets plus depreciation.
  - B. beginning net fixed assets minus ending net fixed assets plus depreciation.
  - C. ending net fixed assets minus beginning net fixed assets minus depreciation.
  - D. ending total assets minus beginning total assets plus depreciation.
  - E. ending total assets minus beginning total assets minus depreciation.

Refer to Section 2.4.

*AACSB: Analytic*  
*Blooms: Remember*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*  
*Section: 2.4*  
*Topic: Net capital spending*

46. Which one of the following relates to a negative change in net working capital?
- A. Increase in the inventory level
  - B. Sale of net fixed assets
  - C. Purchase of net fixed assets
  - D. Increase in current assets and decrease in current liabilities for the period
  - E. Increase in current liabilities with no change in current assets for the period

Refer to Section 2.4.

*AACSB: Analytic*  
*Blooms: Understand*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*  
*Section: 2.4*  
*Topic: Change in net working capital*

47. Which one of the following will increase cash flow from assets but not affect the operating cash flow?
- A. Increase in depreciation
  - B. Increase in accounts receivable
  - C. Sale of a fixed asset
  - D. Decrease in cost of goods sold
  - E. Increase in sales

Refer to Section 2.4.

*AACSB: Analytic*

*Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Cash flow from assets*

48. Cash flow to creditors is equal to:
- A. cash flow from assets plus cash flow to stockholders.
  - B. beginning total liabilities minus ending total liabilities plus interest paid.
  - C. beginning long-term debt minus ending long-term debt plus interest paid.
  - D. ending total debt minus beginning total debt plus interest paid.
  - E. ending long-term debt minus beginning long-term debt plus interest paid.

Refer to Section 2.4.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Cash flow to creditors*

49. Which one of the following indicates that a firm has generated sufficient internal cash flow to finance its entire operations for the period?
- A. Positive operating cash flow
  - B. Negative cash flow to creditors
  - C. Positive cash flow to stockholders
  - D. Negative net capital spending
  - E. Positive cash flow from assets

Refer to Section 2.4.

*AACSB: Analytic  
Blooms: Understand  
Difficulty: 2 Medium  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Cash flow from assets*

50. Kroeger Exporters has total assets of \$74,300, net working capital of \$22,900, owners' equity of \$38,600, and long-term debt of \$23,900. What is the value of the current assets?
- A. \$21,600
  - B. \$24,300
  - C. \$38,900
  - D. \$34,700**
  - E. \$46,100

Current liabilities =  $\$74,300 - \$38,600 - \$23,900 = \$11,800$ ; Current assets =  $\$11,800 + \$22,900 = \$34,700$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Balance sheet

51. Morgantown Movers has net working capital of \$11,300, current assets of \$31,200, equity of \$53,400, and long-term debt of \$11,600. What is the amount of the net fixed assets?
- A. \$31,800
  - B. \$32,900
  - C. \$45,500
  - D. \$48,100
  - E. \$53,700**

Net fixed assets =  $\$11,600 + \$53,400 - \$11,300 = \$53,700$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Balance sheet



52. The Draiman, Inc. currently has \$3,600 in cash. The company owes \$41,800 to suppliers for merchandise and \$21,500 to the bank for a long-term loan. Customers owe The Draiman \$18,000 for their purchases. The inventory has a book value of \$53,300 and an estimated market value of \$61,200. If the store compiled a balance sheet as of today, what would be the book value of the current assets?

- A. \$46,800
- B. \$55,600
- C. \$64,700
- D. \$74,900**
- E. \$96,500

$$\text{Current assets} = \$3,600 + \$18,000 + \$53,300 = \$74,900$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and marketvalue.

Section: 2.1

Topic: Current assets

53. Donut Delite has total assets of \$31,300, long-term debt of \$8,600, net fixed assets of \$19,300, and owners' equity of \$21,100. What is the value of the net working capital?

- A. \$9,800
- B. \$10,400**
- C. \$18,900
- D. \$21,300
- E. \$23,200

$$\text{Net working capital} = \$21,100 + \$8,600 - \$19,300 = \$10,400$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and marketvalue.

Section: 2.1

Topic: Net working capital

54. Early Works had \$87,600 in net fixed assets at the beginning of the year. During the year, the company purchased \$6,400 in new equipment. It also sold, at a price of \$2,300, some old equipment with a book value of \$1,100. The depreciation expense for the year was \$3,700. What is the net fixed asset balance at the end of the year?

- A. \$76,400
- B. \$78,800
- C. \$80,000
- D. \$87,200**
- E. \$89,400

$$\text{Ending net fixed assets} = \$87,600 + \$6,400 - \$1,100 - \$3,700 = \$87,200$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Net fixed assets

55. Plato's Foods has ending net fixed assets of \$84,400 and beginning net fixed assets of \$79,900. During the year, the firm sold assets with a total book value of \$13,600 and also recorded \$14,800 in depreciation expense. How much did the company spend to buy new fixed assets?

- A. -\$23,900
- B. \$3,300
- C. \$32,900**
- D. \$36,800
- E. \$37,400

$$\text{New fixed asset purchases} = \$84,400 - \$79,900 + \$13,600 + \$14,800 = \$32,900$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and marketvalue.

Section: 2.1

Topic: Net fixed assets

56. Red Roofs, Inc. has current liabilities of \$24,300 and accounts receivable of \$7,800. The firm has total assets of \$43,100 and net fixed assets of \$23,700. The owners' equity has a book value of \$21,400. What is the amount of the net working capital?

- A. \$5,100
- B. -\$4,900**
- C. \$6,500
- D. \$18,800
- E. -\$2,600

$$\text{Net working capital} = \$43,100 - \$23,700 - \$24,300 = -\$4,900$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Net working capital

57. Pete's Warehouse has net working capital of \$2,400, total assets of \$19,300, and net fixed assets of \$10,200. What is the value of the current liabilities?

- A. -\$6,700
- B. -\$2,900
- C. \$2,900
- D. \$6,700**
- E. \$11,500

$$\text{Current liabilities} = \$19,300 - \$10,200 - \$2,400 = \$6,700$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Net working capital

58. Baugh and Essary reports the following account balances: inventory of \$17,600, equipment of \$128,300, accounts payable of \$24,700, cash of \$11,900, and accounts receivable of \$31,900. What is the amount of the current assets?

- A. \$46,700
- B. \$56,000
- C. \$61,400**
- D. \$175,000
- E. \$199,700

$$\text{Current assets} = \$17,600 + \$11,900 + \$31,900 = \$61,400$$

AACSB: Analytic

*Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Current assets*

59. Donner United has total owners' equity of \$18,800. The firm has current assets of \$23,100, current liabilities of \$12,200, and total assets of \$36,400. What is the value of the long-term debt?

- A.** \$5,400
- B. \$12,500
- C. \$13,700
- D. \$29,800
- E. \$43,000

$$\text{Long-term debt} = \$36,400 - \$18,800 - \$12,200 = \$5,400$$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Balance sheet*

60. The Braxton Co. has beginning long-term debt of \$64,500, which is the principal balance of a loan payable to Centre Bank. During the year, the company paid a total of \$16,300 to the bank, including \$4,100 of interest. The company also borrowed \$11,000. What is the value of the ending long-term debt?

- A. \$45,100
- B. \$53,300
- C. \$58,200
- D.** \$63,300
- E. \$85,900

$$\text{Ending long-term debt} = \$64,500 - \$16,300 + \$4,100 + \$11,000 = \$63,300$$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Long-term debt*

61. The Toy Store has beginning retained earnings of \$28,975. For the year, the company earned net income of \$4,680 and paid dividends of \$1,600. The company also issued \$3,000 worth of new stock. What is the value of the retained earnings account at the end of the year?
- A. \$20,445
  - B. \$22,695
  - C. \$27,375
  - D. \$32,055**
  - E. \$35,255

$$\text{Retained earnings} = \$28,975 + \$4,680 - \$1,600 = \$32,055$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Retained earnings

62. Leslie Printing has net income of \$26,310 for the year. At the beginning of the year, the firm had common stock of \$55,000, paid-in surplus of \$11,200, and retained earnings of \$48,420. At the end of the year, the firm had total equity of \$142,430. The firm does not pay dividends. What is the amount of the net new equity raised during the year?
- A. \$1,500**
  - B. \$2,500
  - C. \$2,700
  - D. \$48,420
  - E. \$48,310

$$\text{Net new equity} = \$142,430 - \$26,310 - \$55,000 - \$11,200 - \$48,420 = \$1,500$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Net new equity

63. The Embroidery Shoppe had beginning retained earnings of \$18,670. During the year, the company reported sales of \$83,490, costs of \$68,407, depreciation of \$8,200, dividends of \$950, and interest paid of \$478. The tax rate is 35 percent. What is the retained earnings balance at the end of the year?

- A.** \$21,883.25
- B. \$22,193.95
- C. \$22,833.24
- D. \$23,783.24
- E. \$30,393.95

Net income =  $(\$83,490 - \$68,407 - \$8,200 - \$478) \times (1 - 0.35) = \$4,163.25$ ; Ending retained earnings =  $\$18,670 + \$4,163.25 - \$950 = \$21,883.25$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Retained earnings*

64. The owners' equity for The Deer Store was \$58,900 at the beginning of the year. During the year, the company had aftertax income of \$4,200, of which \$3,200 was paid in dividends. Also during the year, the company repurchased \$6,500 of stock from one of the shareholders. What is the value of the owners' equity at year end?

- A.** \$53,400
- B. \$45,000
- C. \$59,900
- D. \$84,400
- E. \$90,900

Ending owners' equity =  $\$58,900 + \$4,200 - \$3,200 - \$6,500 = \$53,400$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Owners' equity*

65. Gino's Winery has net working capital of \$29,800, net fixed assets of \$64,800, current liabilities of \$34,700, and long-term debt of \$23,000. What is the value of the owners' equity?
- A. \$36,900
  - B. \$66,700
  - C. \$71,600**
  - D. \$89,400
  - E. \$106,300

$$\text{Owners' equity} = \$29,800 + \$64,800 - \$23,000 = \$71,600$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Balance sheet

66. The Pier Import Store has cash of \$34,600 and accounts receivable of \$54,200. The inventory cost \$92,300 and can be sold today for \$146,900. The fixed assets were purchased at a cost of \$234,500 of which \$107,900 has been depreciated. The fixed assets can be sold today for \$199,000. What is the total book value of the firm's assets?
- A. \$127,800
  - B. \$307,700**
  - C. \$346,800
  - D. \$382,300
  - E. \$415,600

$$\text{Total book value} = \$34,600 + \$54,200 + \$92,300 + \$234,500 - \$107,900 = \$307,700$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.  
Section: 2.1  
Topic: Book value

67. Lester's Fried Chick'n purchased its building 11 years ago at a cost of \$139,000. The building is currently valued at \$179,000. The firm has other fixed assets that cost \$66,000 and are currently valued at \$58,000. To date, the firm has recorded a total of \$79,000 in depreciation on the various assets. The company has current liabilities of \$36,600 and net working capital of \$18,400. What is the total book value of the firm's assets?

- A.** \$181,000
- B. \$241,000
- C. \$331,000
- D. \$339,000
- E. \$379,000

$$\text{Book value} = \$139,000 + \$66,000 - \$79,000 + \$18,400 + \$36,600 = \$181,000$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Section: 2.1  
Topic: Book value

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

68. The financial statements of Jame's Auto Repair reflect cash of \$14,600, accounts receivable of \$11,500, accounts payable of \$22,900, inventory of \$17,800, long-term debt of \$42,000, and net fixed assets of \$63,800. The firm estimates that if it wanted to cease operations today it could sell the inventory for \$35,000 and the fixed assets for \$49,000. The firm could also collect 100 percent of its receivables. What is the market value of the assets?

- A. \$32,800
- B. \$39,900
- C. \$74,000
- D. \$95,500
- E.** \$110,100

$$\text{Market value} = \$14,600 + \$11,500 + \$35,000 + \$49,000 = \$110,100$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Section: 2.1  
Topic: Market value

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*



69. The Good Life Store has sales of \$79,600. The cost of goods sold is \$48,200 and the other costs are \$18,700. Depreciation is \$8,300 and the tax rate is 34 percent. What is the net income?

- A.** \$2,904
- B. \$8,382
- C. \$11,204
- D. \$14,660
- E. \$16,682

$$\text{Net income} = (\$79,600 - \$48,200 - \$18,700 - \$8,300)(1 - 0.34) = \$2,904$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Income statement

70. Chevelle, Inc. has sales of \$487,000 and costs of \$394,500. The depreciation expense is \$43,800. Interest paid equals \$18,200 and dividends paid equal \$6,500. The tax rate is 35 percent. What is the addition to retained earnings?

- A. \$10,775
- B. \$11,460
- C. \$13,120
- D.** \$13,325
- E. \$15,450

$$\text{Addition to retained earnings} = [(\$487,000 - \$394,500 - \$43,800 - \$18,200)(1 - 0.35)] - \$6,500 = \$13,325$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Addition to retained earnings

71. Last year, The Pizza Joint added \$4,100 to retained earnings from sales of \$93,600. The company had costs of \$74,400, dividends of \$2,500, and interest paid of \$1,400. The tax rate was 34 percent. What was the amount of the depreciation expense?
- A. \$7,300
  - B. \$7,500
  - C. \$7,800**
  - D. \$8,100
  - E. \$8,400

Earnings before interest and taxes =  $[(\$4,100 + \$2,500)/(1 - 0.34)] + \$1,400 = \$11,400$ ;  
Depreciation =  $\$93,600 - \$74,400 - \$11,400 = \$7,800$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Income statement

72. Holly Farms has sales of \$581,600, costs of \$479,700, depreciation expense of \$32,100, and interest paid of \$8,400. The tax rate is 42 percent. How much net income did the firm earn for the period?
- A. \$25,788
  - B. 35,612**
  - C. \$43,380
  - D. \$45,671
  - E. \$45,886

Net income =  $(\$581,600 - \$479,700 - \$32,100 - \$8,400)(1 - 0.42) = \$35,612$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Income statement

73. For the year, Movers United has net income of \$31,800, net new equity of \$7,500, and an addition to retained earnings of \$24,200. What is the amount of the dividends paid?
- A. \$100
  - B. \$7,500
  - C. \$7,600**
  - D. \$15,100
  - E. \$16,700

$$\text{Dividends paid} = \$31,800 - \$24,200 = \$7,600$$

*AACSB: Analytic*  
*Blooms: Analyze*  
*Difficulty: 1 Easy*  
*Learning Objective: 02-02 Distinguish accounting income from cashflow.*  
*Section: 2.2*  
*Topic: Dividends paid*

74. ACE, Inc. incurred depreciation expenses of \$21,900 last year. The sales were \$811,400 and the addition to retained earnings was \$14,680. The firm paid interest of \$9,700 and dividends of \$10,100. The tax rate was 40 percent. What was the amount of the costs incurred by the firm?
- A. \$665,200.00
  - B. \$689,407.67
  - C. \$742,306.08
  - D. \$738,500.00**
  - E. \$780,400.21

$$\begin{aligned} \text{Earnings before interest and taxes} &= [(\$14,680 + \$10,100)/(1 - 0.40)] + \$9,700 = \$51,000; \\ \text{Costs} &= \$811,400 - \$21,900 - \$51,000 = \$738,500 \end{aligned}$$

*AACSB: Analytic*  
*Blooms: Analyze*  
*Difficulty: 2 Medium*  
*Learning Objective: 02-02 Distinguish accounting income from cashflow.*  
*Section: 2.2*  
*Topic: Income statement*

75. Bridgewater Furniture has sales of \$811,000, costs of \$658,000, and interest paid of \$21,800. The depreciation expense is \$56,100 and the tax rate is 34 percent. At the beginning of the year, the firm had retained earnings of \$318,300 and common stock of \$250,000. At the end of the year, the firm has retained earnings of \$322,500 and common stock of \$280,000. What is the amount of the dividends paid for the year?
- A. \$15,266
  - B. \$19,466
  - C. \$31,566
  - D. \$41,066
  - E. \$45,366**

$$\text{Dividends paid} = [(\$811,000 - \$658,000 - \$56,100 - \$21,800)(1 - 0.34)] - (\$322,500 - \$318,300) = \$45,366$$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
Learning Objective: 02-02 Distinguish accounting income from cashflow.  
Section: 2.2  
Topic: Dividends paid*

76. Bama & Co. owes a total of \$21,684 in taxes for this year. The taxable income is \$61,509. If the firm earns \$100 more in income, it will owe an additional \$56 in taxes. What is the average tax rate on income of \$71,609?
- A. 28.00 percent
  - B. 30.33 percent
  - C. 33.33 percent
  - D. 35.00 percent
  - E. 35.29 percent**

$$\text{Average tax rate} = (\$21,684 + \$56)/\$71,609 = 35.29 \text{ percent}$$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-03 Explain the difference between average and marginal tax rates.  
Section: 2.3  
Topic: Average tax rate*

77. Paddle Fans & More has a marginal tax rate of 34 percent and an average tax rate of 23.7 percent. If the firm earns \$138,500 in taxable income, how much will it owe in taxes?

- A. \$31,366.67
- B. \$31,500.00
- C. \$32,824.50**
- D. \$39,957.25
- E. \$47,090.00

$$\text{Tax} = (\$138,500)(0.237) = \$32,824.50$$

AACSB: Analytic

Blooms: Analyze

Difficulty: 1 Easy

Learning Objective: 02-03 Explain the difference between average and marginal tax rates.

Section: 2.3

Topic: Average tax rate

78. Redneck Farm Equipment owes \$48,329 in tax on a taxable income of \$549,600. The company has determined that it will owe \$56,211 in tax if its taxable income rises to \$565,000. What is the marginal tax rate at this level of income?

- A. 9.95 percent
- B. 30.00 percent
- C. 30.67 percent
- D. 51.03 percent
- E. 51.18 percent

$$\text{Marginal tax} = (\$56,211 - \$48,329)/(\$565,000 - \$549,600) = 51.18 \text{ percent}$$

AACSB: Analytic

Blooms: Analyze

Difficulty: 1 Easy

Learning Objective: 02-03 Explain the difference between average and marginal tax rates.

Section: 2.3

Topic: Marginal tax rate

79. Use the following tax table to answer this question:

Taxable Income		Tax Rate
\$ 0-	50,000	15%
50,001-	75,000	25
75,001-	100,000	34
100,001-	335,000	39
335,001-	10,000,000	34

Bait and Tackle has taxable income of \$411,562. How much does it owe in taxes?

- A. \$128,603.33
- B. \$134,611.27
- C. \$138,542.79
- D. \$139,931.08**
- E. \$141,354.82

$$\text{Total tax} = (\$50,000)(0.15) + (\$25,000)(0.25) + (\$25,000)(0.34) + (\$235,000)(0.39) + (\$411,562 - \$335,000)(0.34) = \$139,931.08$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-03 Explain the difference between average and marginal tax rates.

Section: 2.3

Topic: Tax computation

80. Use the following tax table to answer this question:

Taxable Income		Tax Rate
\$ 0-	50,000	15%
50,001-	75,000	25
75,001-	100,000	34
100,001-	335,000	39
335,001-	10,000,000	34

The Holiday Inn earned \$177,284 in taxable income for the year. How much tax does the company owe on this income?

- A. \$46,311.02
- B. \$48,490.76
- C. \$52,390.76**
- D. \$59,998.81
- E. \$65,240.76

$$\begin{aligned} \text{Total tax} &= (\$50,000)(0.15) + (\$25,000)(0.25) + (\$25,000)(0.34) + (\$177,284 - \$100,000)(0.39) \\ &= \$52,390.76 \end{aligned}$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-03 Explain the difference between average and marginal tax rates.  
Section: 2.3

Topic: Tax computation

81. The Plaza Cafe has an operating cash flow of \$78,460, depreciation expense of \$8,960, and taxes paid of \$21,590. A partial listing of its balance sheet accounts is as follows:

	Beginning Balance	Ending Balance
Current assets	\$141,680	\$138,509
Net fixed assets	\$687,810	\$703,411
Current liabilities	\$ 87,340	\$ 91,516
Long-term debt	\$267,000	\$248,000

What is the amount of the cash flow from assets?

- A. \$58,913
- B. \$61,246**
- C. \$61,487
- D. \$63,909
- E. \$64,128

$$\text{Cash flow from assets} = \$78,460 - (\$703,411 - \$687,810 + \$8,960) - [(\$138,509 - \$91,516) - (\$141,680 - \$87,340)] = \$61,246$$

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 2 Medium  
 Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
 Section: 2.4  
 Topic: Cash flow from assets

82. Miser Materials paid \$27,500 in dividends and \$28,311 in interest over the past year while net working capital increased from \$13,506 to \$18,219. The company purchased \$42,000 in net new fixed assets and had depreciation expenses of \$16,805. During the year, the firm issued \$25,000 in net new equity and paid off \$21,000 in long-term debt. What is the amount of the cash flow from assets?

- A. \$21,811
- B. \$30,811
- C. \$36,189
- D. \$49,811
- E. 51,811**

$$\text{Cash flow from assets} = (\$28,311 + \$21,000) + (\$27,500 - \$25,000) = \$51,811$$

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 2 Medium  
 Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
 Section: 2.4  
 Topic: Cash flow from assets



83. The Pretzel Factory has net sales of \$821,300 and costs of \$698,500. The depreciation expense is \$28,400 and the interest paid is \$8,400. What is the amount of the firm's operating cash flow if the tax rate is 34 percent?

- A. \$87,620
- B. \$89,540
- C. \$91,220
- D. \$93,560**
- E. \$95,240

$$\text{EBIT} = \$821,300 - \$698,500 - \$28,400 = \$94,400; \text{Tax} = (\$94,400 - \$8,400) \times 0.34 = \$29,240;$$
$$\text{OCF} = \$94,400 + \$28,400 - \$29,240 = \$93,560$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Operating cash flow

84. The Paint Ball Range, Inc. paid \$30,500 in dividends and \$7,600 in interest over the past year. Sales totaled \$211,800 with costs of \$167,900. The depreciation expense was \$16,500. The applicable tax rate is 34 percent. What is the amount of the operating cash flow?

- A. \$14,232
- B. \$15,306
- C. \$28,222
- D. \$37,168**
- E. \$40,568

$$\text{EBIT} = \$211,800 - \$167,900 - \$16,500 = \$27,400; \text{Tax} = (\$27,400 - \$7,600) \times 0.34 = \$6,732;$$
$$\text{OCF} = \$27,400 + \$16,500 - \$6,732 = \$37,168$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Operating cash flow

85. The balance sheet of a firm shows beginning net fixed assets of \$348,200 and ending net fixed assets of \$371,920. The depreciation expense for the year is \$46,080 and the interest expense is \$11,460. What is the amount of the net capital spending?

- A. -\$22,360
- B. -\$4,780
- C. \$23,720
- D. \$58,340
- E. \$69,800**

$$\text{Net capital spending} = \$371,920 - \$348,200 + \$46,080 = \$69,800$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Net capital spending

86. The financial statements of Backwater Marina reflect depreciation expenses of \$41,600 and interest expenses of \$27,900 for the year. The current assets increased by \$31,800 and the net fixed assets increased by \$28,600. What is the amount of the net capital spending for the year?

- A. \$7,000
- B. \$21,600
- C. \$28,600
- D. \$60,400
- E. \$70,200**

$$\text{Net capital spending} = \$28,600 + \$41,600 = \$70,200$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Net capital spending

87. Andre's Dog House had current assets of \$67,200 and current liabilities of \$71,100 last year. This year, the current assets are \$82,600 and the current liabilities are \$85,100. The depreciation expense for the past year is \$9,600 and the interest paid is \$8,700. What is the amount of the change in net working capital?
- A. -\$2,800  
 B. -\$1,400  
**C. \$1,400**  
 D. \$2,100  
 E. \$2,800

$$\text{Change in net working capital} = (\$82,600 - \$85,100) - (\$67,200 - \$71,100) = \$1,400$$

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 1 Easy  
 Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
 Section: 2.4  
 Topic: Change in net working capital

88. The balance sheet of Binger, Inc. has the following balances:

	Beginning balance	Ending balance
Cash	\$21,400	\$16,800
Accounts receivable	47,400	52,300
Inventory	83,800	77,400
Net fixed assets	211,600	203,800
Accounts payable	54,900	56,900
Long-term debt	170,000	185,000

What is the amount of the change in net working capital?

- A. -\$8,100**  
 B. -\$7,400  
 C. \$7,700  
 D. \$8,000  
 E. \$8,100

$$\text{Change in net working capital} = (\$16,800 + \$52,300 + \$77,400 - \$56,900) - (\$21,400 + \$47,400 + \$83,800 - \$54,900) = -\$8,100$$

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 1 Easy  
 Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
 Section: 2.4  
 Topic: Change in net working capital

89. During the past year, Arther Anderson Services paid \$360,800 in interest along with \$48,000 in dividends. The company issued \$230,000 of stock and \$200,000 of new debt. The company reduced the balance due on the old debt by \$225,000. What is the amount of the cash flow to creditors?
- A. -\$88,200
  - B. \$51,400
  - C. \$161,800
  - D. \$385,800**
  - E. \$585,800

$$\text{Cash flow to creditors} = \$360,800 - \$200,000 + \$225,000 = \$385,800$$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Cash flow to creditors*

90. A firm has earnings before interest and taxes of \$25,380 with a net income of \$14,220. The taxes amounted to \$5,400 for the year. During the year, the firm paid out \$43,800 to pay off existing debt and then later borrowed an additional \$24,000. What is the amount of the cash flow to creditors?
- A. -\$14,040
  - B. \$19,800
  - C. \$25,560**
  - D. \$28,440
  - E. \$29,790

$$\text{Interest} = \$25,380 - \$14,220 - \$5,400 = \$5,760; \text{Cash flow to creditors} = \$5,760 + \$43,800 - \$24,000 = \$25,560$$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Cash flow to creditors*

91. The balance sheet of a firm shows current liabilities of \$56,300 and long-term debt of \$289,200 as of last year. Current liabilities are \$76,900 and long-term debt is \$248,750 as of today, which is the end of the current year. The financial statements for the current year reflect an interest paid amount of \$29,700 and dividends of \$19,000. What is the amount of the net new borrowing?

- A.** -\$40,450
- B. \$40,450
- C. \$64,750
- D. \$70,150
- E. \$78,250

Net new borrowing =  $\$248,750 - \$289,200 = -\$40,450$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Net new borrowing*

92. For the past year, LP Gas, Inc. had cash flow from assets of \$38,100 of which \$21,500 flowed to the firm's stockholders. The interest paid was \$2,300. What is the amount of the net new borrowing?

- A.** -\$14,300
- B. -\$9,700
- C. \$12,300
- D. \$14,300
- E. \$18,900

Cash flow to creditors =  $\$38,100 - \$21,500 = \$16,600$ ; Net new borrowing =  $\$2,300 - \$16,600 = -\$14,300$

*AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Net new borrowing*

93. Six months ago, Benders Gym repurchased \$20,000 of its common stock. The company pays regular quarterly dividends totaling \$8,500 per quarter. What is the amount of the cash flow to stockholders for the past year if no additional shares were issued?

A. -\$10,000  
B. \$20,000  
C. \$28,500  
D. \$30,000  
**E. \$54,000**

$$\text{Cash flow to stockholders} = (\$8,500 \times 4) + \$20,000 = \$54,000$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Cash flow to stockholders

94. The Underground Cafe has an operating cash flow of \$187,000 and a cash flow to creditors of \$71,400 for the past year. During that time, the firm invested \$28,000 in net working capital and incurred net capital spending of \$47,900. What is the amount of the cash flow to stockholders for the last year?

A. -\$171,500  
B. -\$86,700  
C. \$21,200  
**D. \$39,700**  
E. \$111,100

$$\text{Cash flow to stockholders} = (\$187,000 - \$28,000 - \$47,900) - \$71,400 = \$39,700$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Cash flow to stockholders

95. The Brown Jug has compiled the following information:

	<u>2013</u>	<u>2014</u>
Sales	\$312,400	\$198,500
Interest paid	18,720	16,480
Long-term debt	225,000	187,000
Owners' equity	134,600	128,700
Depreciation	21,600	20,200
Accounts receivable	15,600	18,900
Other costs	32,400	27,100
Inventory	36,800	32,800
Accounts payable	12,800	21,900
Cost of goods sold	186,200	128,300
Cash	36,500	12,700
Taxes	18,200	1,000

What is the operating cash flow for 2014?

- A. \$21,900
- B. \$26,700
- C. \$42,100**
- D. \$48,300
- E. \$52,600

$$2014 \text{ operating cash flow} = \$198,500 - \$27,100 - \$128,300 - \$1,000 = \$42,100$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
Section: 2.4  
Topic: Operating cash flow

96. Home Supply, Inc. has compiled the following information:

	<u>2013</u>	<u>2014</u>
Sales	\$427,400	\$511,500
Interest paid	19,800	21,600
Long-term debt	260,000	295,000
Common stock	150,000	160,000
Depreciation	24,600	23,500
Accounts receivable	38,200	34,900
Other costs	58,400	61,100
Inventory	58,800	56,800
Accounts payable	36,800	32,900
Cost of goods sold	274,200	289,300
Cash	41,500	36,700
Taxes	11,400	39,400
Net fixed assets	336,900	392,200
Retained earnings	28,600	32,700

For 2014, the cash flow from assets is \_\_\_\_\_ and the cash flow to shareholders is \_\_\_\_\_.

- A. \$49,100; \$62,500
- B. \$49,100; \$76,800
- C. \$49,100; \$81,100
- D. \$56,400; \$76,800
- E. \$56,400; \$79,300

2014 operating cash flow = \$511,500 - \$61,100 - \$289,300 - \$39,400 = \$121,700; Change in net working capital = (\$34,900 + \$56,800 - \$32,900 + \$36,700) - (\$38,200 + \$58,800 - \$36,800 + \$41,500) = -\$6,200; Net capital spending = \$392,200 - \$336,900 + \$23,500 = \$78,800; Cash flow from assets = \$121,700 - (-\$6,200) - \$78,800 = \$49,100; Cash flow to creditors = \$21,600 - (\$295,000 - \$260,000) = -\$13,400; Addition to retained earnings = \$32,700 - \$28,600 = \$4,100; Net income = \$511,500 - \$289,300 - \$61,100 - \$23,500 - \$21,600 - \$39,400 = \$76,600; Dividends paid = \$76,600 - \$4,100 = \$72,500; Cash flow to stockholders = \$72,500 - (\$160,000 - \$150,000) = \$62,500; Cash flow from assets = -\$13,400 + \$62,500 = \$49,100

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 2 Medium

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4  
 Topic: Cash flows



97. The Carpentry Shop has sales of \$398,600, costs of \$254,800, depreciation expense of \$26,400, interest expense of \$1,600, and a tax rate of 34 percent. What is the net income for this firm?

- A. \$61,930
- B. \$66,211
- C. \$67,516
- D. \$76,428**
- E. \$83,219

$$\text{Net income} = (\$398,600 - \$254,800 - \$26,400 - \$1,600) (1 - 0.34) = \$76,428$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
EOC: #2.2

Learning Objective: 02-02 Distinguish accounting income from cashflow.

Section: 2.2

Topic: Net income

98. Andersen's Nursery has sales of \$318,400, costs of \$199,400, depreciation expense of \$28,600, interest expense of \$1,100, and a tax rate of 34 percent. The firm paid out \$16,500 in dividends. What is the addition to retained earnings?

- A. \$36,909
- B. \$42,438**
- C. \$44,141
- D. \$47,208
- E. \$47,615

$$\text{Addition to retained earnings} = [(\$318,400 - \$199,400 - \$28,600 - \$1,100)(1 - 0.34)] - \$16,500 = \$42,438$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
EOC: #2.3

Learning Objective: 02-02 Distinguish accounting income from cashflow.

Section: 2.2

Topic: Addition to retained earnings

99. Roscoe's purchased new machinery three years ago for \$1.8 million. The machinery can be sold to Stewart's today for \$1.2 million. Roscoe's current balance sheet shows net fixed assets of \$960,000, current liabilities of \$348,000, and net working capital of \$121,000. If all the current assets were liquidated today, the company would receive \$518,000 cash. The book value of the firm's assets today is \_\_\_\_\_ and the market value is \_\_\_\_\_.

- A. \$1,081,000; \$1,308,000
- B. \$1,081,000; \$1,718,000
- C. \$1,307,000; \$1,429,000
- D. \$1,429,000; \$1,308,000
- E. \$1,429,000; \$1,718,000**

Book value = \$960,000 + \$348,000 + \$121,000 = \$1,429,000; Market value = \$1,200,000 + \$518,000 = \$1,718,000

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
EOC: #2.5

Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.

Section: 2.1

Topic: Market and book values

100. Daniel's Market has sales of \$36,600, costs of \$28,400, depreciation expense of \$3,100, and interest expense of \$1,500. If the tax rate is 34 percent, what is the operating cash flow, OCF?

- A. \$4,811
- B. \$5,279
- C. \$6,466
- D. \$6,976**
- E. \$7,013

EBIT = \$36,600 - \$28,400 - \$3,100 = \$5,100; Tax = (\$5,100 - \$1,500) × 0.34 = \$1,224; OCF = \$5,100 + \$3,100 - \$1,224 = \$6,976

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
EOC: #2.8

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Operating cash flow

101. The Play House's December 31, 2013, balance sheet showed net fixed assets of \$1,238,000 and the December 31, 2014, balance sheet showed net fixed assets of \$1,416,000. The company's 2014 income statement showed a depreciation expense of \$214,600. What was the firm's net capital spending for 2014?
- A. \$36,600
  - B. \$42,400
  - C. \$392,600**
  - D. \$404,400
  - E. \$416,600

$$\text{Net capital spending} = \$1,416,000 - \$1,238,000 + \$214,600 = \$392,600$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
EOC: #2.9

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Net capital spending

102. The December 31, 2013, balance sheet of Suzette's Market showed long-term debt of \$638,100 and the December 31, 2014, balance sheet showed long-term debt of \$574,600. The 2010 income statement showed an interest expense of \$42,300. What was the firm's cash flow to creditors during 2014?
- A. \$21,200
  - B. \$26,700
  - C. \$54,900
  - D. \$102,400
  - E. \$105,800**

$$\text{Cash flow to creditors} = \$42,300 - (\$574,600 - \$638,100) = \$105,800$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 1 Easy  
EOC: #2.11

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4

Topic: Cash flow to creditors

103. Gorman Distributors shows the following information on its 2014 income statement: sales = \$317,800; costs = \$211,400; other expenses = \$18,500; depreciation expense = \$31,200; interest expense = \$2,100; taxes = \$18,600; dividends = \$12,000. In addition, you're told that the firm issued \$4,500 in new equity during 2014, and redeemed \$6,500 in outstanding long-term debt. If net fixed assets increased by \$7,400 during the year, what was the addition to net working capital?

- A. \$17,900  
**B. \$14,600**  
 C. \$15,800  
 D. \$16,200  
 E. \$17,400

OCF - \$317,800 - \$211,400 - \$18,500 - \$18,600 = \$69,300; NCS = \$7,400 + \$31,200 = \$38,600; CFA = CFC + CFS = [\$2,100 - (-\$6,500)] + [\$12,000 - \$4,500] = \$16,100; Add to NWC = OCF - NCS - CFA = \$69,300 - \$38,600 - \$16,100 = \$14,600

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 2 Medium  
 EOC: #2.14

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.  
 Section: 2.4

Topic: Net working capital

104. Able Co. has \$218,000 in taxable income and Bravo Co. has \$5,600,000 in taxable income. Suppose both firms have identified a new project that will increase taxable income by \$12,000. The additional project will increase Able Co.'s taxes by \_\_\_\_\_ and Bravo Co.'s taxes by \_\_\_\_\_.

Taxable Income		Tax Rate
\$ 0-	50,000	15%
50,001-	75,000	25
75,001-	100,000	34
100,001-	335,000	39
335,001-	10,000,000	34

- A. \$1,800; \$1,800  
 B. \$4,080; \$4,080  
 C. \$4,080; \$4,680  
**D. \$4,680; \$4,080**  
 E. \$4,680; \$4,680

Able Co. marginal tax = \$12,000 × 0.39 = \$4,680; Bravo Co. marginal tax = \$12,000 × 0.34 = \$4,080

AACSB: Analytic  
 Blooms: Analyze  
 Difficulty: 2 Medium  
 EOC: #2.18

Learning Objective: 02-03 Explain the difference between average and marginal tax rates.

105. During the year, The Dalton Firm had sales of \$3,210,000. Cost of goods sold, administrative and selling expenses, and depreciation expenses were \$2,540,000, \$389,000, and \$112,000, respectively. In addition, the company had an interest expense of \$118,000 and a tax rate of 34 percent. (Ignore any tax loss carryback or carryforward provisions.) What is its operating cash flow?

- A.** \$263,660
- B. \$271,420
- C. \$273,330
- D. \$285,400
- E. \$287,700

$$\text{EBIT} = [(\$3,210,000 - \$2,540,000 - \$389,000 - \$112,000) = \$169,000; \text{Tax} = (\$169,000 - \$118,000) \times 0.34 = \$17,340; \text{OCF} = \$169,000 + \$112,000 - \$17,340 = \$263,660$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
EOC: #2.19

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4  
Topic: Operating cash flow

106. Precision Manufacturing had the following operating results for 2014: sales = \$38,900; cost of goods sold = \$24,600; depreciation expense = \$1,700; interest expense = \$1,400; dividends paid = \$1,000. At the beginning of the year, net fixed assets were \$14,300, current assets were \$8,700, and current liabilities were \$6,600. At the end of the year, net fixed assets were \$13,900, current assets were \$9,200, and current liabilities were \$7,400. The tax rate for 2014 was 34 percent. What is the cash flow from assets for 2014?

- A. \$8,047
- B. \$8,292
- C. \$8,658
- D.** \$9,492
- E. \$9,964

$$\text{OCF} = [(\$38,900 - \$24,600 - \$1,700 - \$1,400) (1 - 0.34)] + \$1,700 + \$1,400 = \$10,492; \text{CFA} = \$10,492 - (\$13,900 - \$14,300 + \$1,700) - [(\$9,200 - \$7,400) - \$8,700 - \$6,600] = \$9,492$$

AACSB: Analytic  
Blooms: Analyze  
Difficulty: 2 Medium  
EOC: #2.21

Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.

Section: 2.4  
Topic: Cash flow from assets

## Essay Questions

107. How can a firm determine if its level of liquidity is appropriate?

If a firm has too little liquidity, it will encounter problems with its cash flow and at times have insufficient funds on hand to pay its debts. If a firm has too much liquidity, it will have extra cash that it never needs for its daily operations. Thus, the appropriate level of liquidity is somewhere in the middle between too little and too much.

Feedback: If a firm has too little liquidity, it will encounter problems with its cash flow and at times have insufficient funds on hand to pay its debts. If a firm has too much liquidity, it will have extra cash that it never needs for its daily operations. Thus, the appropriate level of liquidity is somewhere in the middle between too little and too much.

*AACSB: Reflective Thinking*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-01 Differentiate between accounting value (or "book" value) and market value.*

*Section: 2.1*

*Topic: Liquidity*

108. Which is more important from a finance perspective—net income or operating cash flow? What is the difference between these two values?

From a finance perspective, operating cash flow is more important because it reveals the actual net amount of cash generated or used by a firm's daily operations. The difference between net income and operating cash flow consists of depreciation and other noncash expenses plus the interest paid.

Feedback: From a finance perspective, operating cash flow is more important because it reveals the actual net amount of cash generated or used by a firm's daily operations. The difference between net income and operating cash flow consists of depreciation and other noncash expenses plus the interest paid.

*AACSB: Reflective Thinking*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*

*Section: 2.4*

*Topic: Operating cash flow*

109. Explain why the marginal tax rate, rather than the average tax rate, is used when computing the cash flows from a proposed new project.

The marginal tax rate is used because that is the tax rate that will apply to the incremental taxable income generated by the new project.

Feedback: The marginal tax rate is used because that is the tax rate that will apply to the incremental taxable income generated by the new project.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-03 Explain the difference between average and marginal tax rates.*

*Section: 2.3*

*Topic: Marginal tax rate*

110. Identify the cash flows that occur between a firm and its shareholders and explain how each of these cash flows affects the cash flow to stockholders.

The three cash flows that occur between a firm and its shareholders are dividends, sale of stock, and stock repurchase. Dividends and stock repurchases increase the cash flow to stockholders while the sale of stock reduces the cash flow to stockholders.

Feedback: The three cash flows that occur between a firm and its shareholders are dividends, sale of stock, and stock repurchase. Dividends and stock repurchases increase the cash flow to stockholders while the sale of stock reduces the cash flow to stockholders.

*AACSB: Reflective Thinking*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-04 Determine a firm's cash flow from its financial statements.*

*Section: 2.4*

*Topic: Cash flow to stockholders*