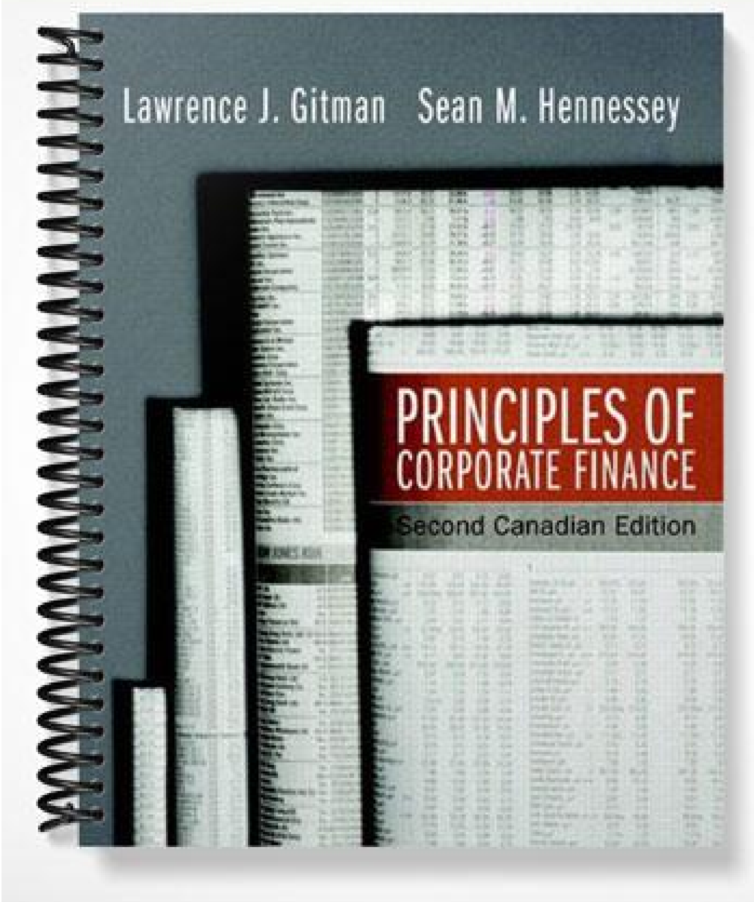
TEST BANK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PRINCIPLES OF
CORPORATE FINANCE
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TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) GAAP is the accounting profession's rule-setting body. 1) _______

2) Generally Accepted Accounting Principles are authorized by the Canadian Institute of Chartered Accountants. 2) _______

3) Publicly owned corporations are those which are financed by proceeds from government treasury securities. 3) _______

4) Publicly owned corporations are required by the provincial securities commissions and stock exchanges to provide their stockholders with an annual stockholders' report. 4) _______

5) The president's letter, as the first component of the stockholders' report, is the primary communication from management to the firm's employees. 5) _______

6) Common stock dividends paid to stockholders are equal to the earnings available for common stockholders divided by the number of shares of common stock outstanding. 6) _______

7) The income statement is a financial summary of the firm's operating results during a specified period, while the balance sheet is a summary statement of the firm's financial position at a given point in time. 7) _______

8) The par value of common stock is an arbitrarily assigned per share value used primarily for accounting purposes. 8) _______

9) The stated (par) value on preferred stock represents the actual price for which the shares must be sold. 9) _______

10) Earnings per share represents the amount earned during the period on each outstanding share of common stock. 10) ______

11) Net fixed assets represent the difference between gross fixed assets and the total expense recorded for the depreciation of fixed assets. 11) ______

12) Earnings per share results from dividing earnings available for common stockholders by the number of shares of common stock authorized. 12) ______

13) Retained earnings represents the cumulative total of all earnings retained and reinvested in the firm since its inception. 13) ______

14) The balance sheet is a statement which balances the firm's assets (what it owns) against its debt (what it owes). 14) ______

15) Common stock consists of two components, contributed capital and retained earnings. 15) ______

16) The original price per share received by the firm on a single issue of common stock is equal to the the contributed capital divided by the nu er of
mb shares

outstand ing. 16)

17) A statement of cash flows reconciles the net income earned during a given year, and any cash dividends paid, with the change in retained earnings between the start and end of that year. 17) ______

18) The statement of cash flows provides insight into the firm's assets and liabilities and reconciles them with changes in its cash and marketable securities during the period of concern. 18) ______

19) Both present and prospective shareholders are interested in the firm's current and future level of risk and return. These two dimensions directly affect share price. 19) ______

20) The depreciable life of an asset can significantly affect the pattern of cash flows. The shorter the depreciable life of an asset, the more quickly the cash flow created by the depreciation write-off will be received. 20) ______

21) Noncash charges are expenses that involve an actual outlay of cash during the period but are not deducted on the income statement. 21) ______

22) Under the capital cost allowance (CCA) procedures, the depreciable value of a fixed asset is its full cost, including outlays for installation. 22) ______

23) Business firms are permitted to systematically charge a portion of the market value of fixed assets, as depreciation, against annual revenues. 23) ______

24) Given the financial manager's preference for faster receipt of cash flows, a longer depreciable life is preferred to a shorter one. 24) ______

25) The CCA depreciation method requires use of the half-year convention. Assets are assumed to be acquired in the middle of the year and only one-half of the first year's depreciation is recovered in the first year. 25) ______

26) In finance, operating cash flow is the cash flow a firm generates from its normal operations, calculated as EBIT - taxes + depreciation. 26) ______

27) The finance definition of operating cash flow excludes interest as an operating flow, whereas the accounting definition includes it as an operating flow. 27) ______

28) The net fixed asset investment is defined as the change in net fixed assets plus amortization expense for the period. 28) ______

29) The net working capital investment is defined as the change in current assets minus the change in current liabilities. 29) ______

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

pay cash dividends. 30) ___

31) Cash flow from operations is equal to the firm's net income after taxes minus all noncash charges. 31) ______

32) In the statement of cash flow, the operating cash flows are cash flows directly related to purchase and sale of fixed assets. 32) ______

33) An increase in the firm's cash balance is a source of cash flow. 33) ______

34) Amortization is considered to be use of cash flow since the cash must be drawn from somewhere. 34) ______

35) The statement of cash flows allows the financial manager and other interested parties to analyze the firm's past and possibly future profitability. 35) ______

36) To assess whether any developments have occurred that are contrary to the company's financial policies, the financial manager should pay special attention to both the major categories of cash flow and the individual items of cash inflow and outflow. 36) ______

37) Because amortization is treated as a separate source of cash, only net rather than gross changes in fixed assets appear on the statement of cash flows. 37) ______

38) The ordinary income of a corporation is income earned through the sale of a firm's goods and services and is currently taxed subject to the individual income tax rates. 38) ______

39) The marginal tax rate represents the rate at which additional income is taxed. 39) ______

40) The CICA has developed a set of accounting standards that specify the four financial statements that companies must develop and how information is to be presented and disclosed in the financial statements. 40) ______

41) Amortization is the systematic expensing of a portion of the cost of a fixed asset against sales. 41) ______

42) A long-term government of Canada bond is considered a marketable security. 42) ______

43) The sale of every business requires a premium be paid to cover the cost of goodwill. 43) ______

44) An increase in a firm's inventory account results in an outflow of cash. 44) ______

45) An increase in the accounts payable account results in a outflow of cash. 45) ______

46) Dividends paid to shareholders requires an outflow of cash. 46) ______

47) A share of stock was purchased for $2 and sold 3 years later for $5. The $5 increase in value is taxed as a capital gain. 47) ______

48) An investor receives a $500 dividend cheque from Bell Canada; this is considered passive income. 48) ______

49) Canadian- controlled private corporations have tax advantages relative to public companies. 49) ______

50) A Canadian-controlled private corporation's first $500,000 of taxable income qualifies for the small business deduction. 50) ______

51) The manufacturing and processing deduction allows manufacturing and processing businesses a 7 percent reduction from the effective general federal tax rate in 2001. 51) ______

52) Capital cost allowance is simply the tax version of amortization. 52) ______

53) The Canada Customs and Revenue Agency provides businesses with a table of CCA rates used to amortize fixed assets for tax purposes. 53) ______

54) The Canadian Institute of Chartered Accountants, part of the Accounting Standards Board, is the accounting profession's rule-setting body that authorizes accounting practices and principles. 54) ______

55) Unlike the United States, in Canada public corporations have no obligation to report their financial results through an annual report to shareholders. 55) ______

56) The more risky an investment, the greater the investor's expected return and the greater the probability of less than desireable results. 56) ______

57) A benefit of holding cash is the liquidity it gives the firm. 57) ______

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

58) One of the most influential documents issued by a publicly held corporation is the 58) ______

A) cash flow statement. B) annual report.
C) income statement. D) letter to stockholders.

59) The rule-setting body, which authorizes generally accepted accounting principles is the 59) ______

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

60) Accounting practices and procedures used to prepare financial statements are called 60) ______

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

61) The stockholder's annual report must include 61) ______
A) a balance sheet.
B) an income statement.
C) a statement of cash flows.
D) all of the above.

62) The stockholder's report may include all of the following EXCEPT 62) ______
A) a cash budget.
B) a statement of retained earnings.
C) an income statement.
D) a statement of cash flows.

63) Total assets less net fixed assets equals 63) ______
A) current assets.
B) gross assets.
C) liabilities and equity.
D) depreciation.

64) The ________ provides a financial summary of the firm's operating results during a specified period. 64) ______
A) statement of retained earnings
B) balance sheet
C) income statement
D) statement of cash flows

65) Gross profits are defined as 65) ______
A) sales revenue minus operating expenses.
B) operating profits minus cost of goods sold.
C) operating profits minus depreciation.
D) sales revenue minus cost of goods sold.

66) Operating profits are defined as 66) ______
A) sales revenue minus cost of goods sold.
B) sales revenue minus depreciation expense.
C) earnings before depreciation and taxes.
D) gross profits minus operating expenses.

67) Net income after taxes are defined as 67) ______
A) gross profits minus operating expenses.
B) sales revenue minus cost of goods sold.
C) EBIT minus interest and taxes.
D) EBIT minus interest.

68) Operating profits are defined as 68) ______
A) sales revenue minus cost of goods sold.
B) earnings after taxes.
C) earnings before interest and taxes.
D) earnings before depreciation and taxes.

69) Earnings available to common shareholders are defined as net income 69) ______
A) after taxes.
B) before taxes.
C) after taxes minus preferred dividends.
D) after taxes minus common dividends.

70) All of the following are examples of current assets EXCEPT 70) ______

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

71) All of the following are examples of fixed assets EXCEPT 71) ______
A) marketable securities. B) automobiles.
C) buildings. D) equipment.

72) All of the following are examples of current liabilities EXCEPT 72) ______
A) accruals. B) notes payable.
C) accounts receivable. D) accounts payable.

73) The net value of fixed assets is also called their 73) ______
A) par value. B) book value.
C) market value. D) price.

74) The ________ represents a summary statement of the firm's financial position at a given point in time. 74) ______
A) statement of retained earnings
B) statement of cash flows
C) income statement
D) balance sheet

75) The ________ summarizes the firm's funds flow over a given period of time. 75) ______
A) statement of retained earnings
B) statement of cash flows
C) income statement
D) balance sheet

76) The statement of cash flows may also be called the 76) ______
A) statement of retained earnings.
B) bank statement.
C) sources and uses statement.
D) funds statement.

77) Retained earnings on the balance sheet represents 77) ______
A) net profits after taxes minus preferred dividends.
B) net profits after taxes.
C) the cumulative total of earnings reinvested in the firm.
D) cash.

78) The statement of retained earnings reports all of the following EXCEPT 78) ______
A) interest. B) common stock dividends.
C) net profits after taxes. D) preferred stock dividends.

79) When preparing a statement of cash flows, retained earnings adjustments are required so that which of the following are separated on the statement? 79) ______
A) depreciation and purchases B) net profits and dividends
C) assets and liabilities D) revenue and cost

80) A firm has the following accounts and financial data for 2003: Sales

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

80) ______

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

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

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

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

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

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

82) A firm has the following accounts and financial data for 2003: 82) ______

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

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

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

83) On the balance sheet net fixed assets represent 83) ______

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

D) gross fixed assets at market value minus accumulated deprecation.

84) Firm ABC has operating profits of $100,000, taxes of $17,000, interest expense of $34,000 and preferred dividends of $5,000. What is the firm's net income after taxes? 84) ______

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

85) Candy Corporation has pretax profits of $1.2 million, an average tax rate of 34 percent, and it pays preferred dividends of $50,000. There are 100,000 shares outstanding and no interest expenses. What is Candy Corporation's earnings per share? 85) ______

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

86) A firm has year end 2001 and 2002 retained earnings balances of $670,000 and $560,000, respectively. The firm paid $10,000 in dividends in 2002. The firm's net income after taxes in 2002 is ________. 86) ______

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

87) A corporation has year end 2001 and 2002 retained earnings balances of $320,000 and $400,000, respectively. The firm reported net income after taxes of $100,000 in 2002. The firm paid dividends in 2002 of ________. 87) ______

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

88) A corporation has a year end 2001 retained earnings balance of $220,000. The firm reported net income after taxes of $50,000 in 2002 and paid dividends in 2002 of $30,000. The firm's retained earnings balance at year end 2002 is ________. 88) ______

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

89) A firm has year end 2001 and 2002 retained earnings balances of $670,000 and $560,000, respectively. The firm reported net profits after taxes of $100,000 in 2002. The firm paid dividends in 2002 of ________. 89) ______

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

90) The tax deductibility of expenses ________ their after-tax cost. 90) ______

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

91) A capital gain occurs when an asset has been held for 91) ______

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

92) Corporations experiencing operating losses are allowed to 92) ______

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

93) Jennings, Inc. has a tax liability of $170,000 on pretax income of $500,000. What is the average tax rate for Jennings, Inc.? 93) ______

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

94) The average tax rate of a corporation with ordinary income of $105,000 and a tax liability of $24,200 is 94) ______

A) 46 percent. B) 15 percent.
C) 34 percent. D) 23 percent.

95) If a corporation sells certain assets for more than their initial purchase price, the difference between the sale price and the purchase price is called 95) ______

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

96) Capital gains are taxed at ________ of the investor's marginal tax rate. 96) ______

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

97) Parliament allows Canadian corporations to exclude from taxes 100 percent of dividends received from other Canadian corporations. Parliament did this to 97) ______

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

98) Corporation X needs $1,000,000 and can raise this through debt at an annual rate of 10 percent, or preferred stock at an annual cost of 7 percent. If the corporation has a 40 percent tax rate, the after-tax cost of each is 98) ______

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

99) Corporation A owns 15 percent of the stock of corporation B. Corporation B pays corporation A $100,000 in dividends in 2002. Corporation A must pay tax on 99) ______

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

100) The dividend exemption for Canadian corporations receiving dividends from another Canadian corporation has resulted in 100) _____

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

101) A corporation had an operating loss in 2002. All prior years had positive earnings. In utilizing the tax laws on carrybacks and carryforwards on operating losses a corporation 101) _____
A) must first carryback the loss to 2001, then to 2000 and 1999.
B) has the option of selecting whether to carryforward or carryback the loss.
C) must first carryback the loss to 1999, then to 2000 and 2001.
D) must carryback the operating loss for at least one year before it can carryforward.

102) All of the following are true EXCEPT 102) _____
A) Corporations pay taxes on all dividends received from other corporations, regardless of their share of ownership.
B) Interest income received by a corporation is taxed as ordinary income.
C) Capital gains is taxed as ordinary income.
D) Corporations may pay taxes on only 30 percent of the dividends received from other corporations, depending on their percentage of ownership.

FIGURE 2.1

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

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

103) If the corporation in Figure 2.1 had a 40 percent tax rate for all years, they received a tax refund in 2000 in the amount of 103) _____
A) $480,000 B) $80,000 C) $320,000 D) $240,000

104) The corporation in Figure 2.1 had taxable income in 2001 of 104) _____
A) $0 B) $160,000
C) $200,000 D) -$200,000

105) In 2002 the corporation in Figure 2.1 will have taxable income of 105) _____
A) $100,000 B) $300,000 C) $200,000 D) $0

106) Allocation of the historic costs of fixed assets against the annual revenue they generate is called 106) _____
A) amortization. B) gross profits.
C) net profits. D) variable costing.

107) The capital cost allowance (CCA) system is the depreciation method used for ________ purposes. 107) _____
A) financial reporting B) cost accounting
C) managerial D) tax

108) A firm's operating cash flow is defined as 108) _____

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

109) A corporation 109) _____
A) must use different (from for tax purposes), but strictly mandated, depreciation methods for financial reporting purposes.
B) must use the same depreciation method for tax and financial reporting purposes.
C) must use different depreciation methods for tax and financial reporting purposes.
D) may use different depreciation methods for tax and financial reporting purposes.

110) All of the following are noncash charges EXCEPT 110) _____
A) depreciation. B) amortization.
C) accruals. D) depletion.

111) The depreciable value of an asset, under CCA, is 111) _____
A) the original cost plus installation.
B) the original cost plus installation costs, minus salvage value.
C) the original cost minus salvage value.
D) the original cost (purchase price) only.

112) Under CCA, an asset which originally cost $10,000 is being depreciated using a 20% CCA rate. What is the depreciation expense in year 2? 112) _____
A) $2,100 B) $1,800 C) $1,500 D) $1,200

113) Under CCA, an asset which originally cost $100,000 is being depreciated using a 30% CCA rate. The depreciation expense in year 3 is ________. 113) _____
A) $10,440 B) $21,000 C) $12,030 D) $17,850

114) Under CCA, an asset which originally cost $100,000 is being depreciated using a 4% CCA rate. The depreciation expense in year 1 is ________. 114) _____
A) $2,000 B) $6,000 C) $0 D) $4,000

115) Given the financial manager's preference for faster receipt of cash flows, 115) _____
A) the manager is not concerned with depreciable lives, because depreciation is a non-cash expense.
B) the manager is not concerned with depreciable lives, because once purchased, depreciation is considered a sunk cost.
C) a longer depreciable life is preferred to a shorter one.
D) a shorter depreciable life is preferred to a longer one.

116) The depreciable life of an asset is of concern to the financial manager, and 116) _____
A) a shorter depreciable life is preferred, because it will result in a faster receipt of cash flows.
B) a longer depreciable life is preferred, because it will result in a faster receipt of cash flows.
C) a longer depreciable life is preferred, because management can

postpone purchasing new assets, since the old assets still have a useful life.
D) a shorter depreciable life is preferred, because management can then purchase new assets, as the old assets are written off.

117) The depreciable value of an asset, under CCA, is 117) _____
A) the full cost minus salvage value.
B) the full cost excluding installation costs.
C) the full cost including installation costs.
D) the full cost including installation costs adjusted for the salvage value.

118) Under CCA, an asset which originally cost $100,000, incurred installation costs of $10,000, and has an estimated salvage value of $25,000, is being depreciated using a 30% CCA rate. What is the depreciation expense in year 1? 118) _____
A) $16,500 B) $15,000 C) $11,250 D) $12,750

119) Which of the following is a source of cash flows? 119) _____
A) interest expense B) amortization
C) taxes D) cost of goods sold

120) Financial cash flows through the firm include 120) _____
A) salaries. B) rent.
C) interest expense. D) labor expense.

121) The first step in preparing a statement of cash flows is to 121) _____
A) calculate the amortization expense.
B) adjust retained earnings.
C) calculate changes in income statement accounts.
D) calculate changes in balance sheet accounts.

122) When preparing a statement of cash flows, retained earnings adjustments are required so that which of the following are separated on the statement? 122) _____
A) net income and dividends B) amortization and purchases
C) revenue and cost D) assets and liabilities

123) The cash flows from operating activities of the firm include 123) _____
A) interest expense. B) dividends paid.
C) cost of raw materials. D) stock repurchases.

124) The cash flows from operating activities of the firm include 124) _____
A) dividends paid. B) labor expense.
C) taxes paid. D) interest expense.

125) Inputs to the statement of cash flows from the income statement include all of the following EXCEPT 125) _____
A) cash dividends.
B) net income after tax.
C) operating profit.
D) non-cash charges, such as amortization.

126) The statement of cash flows includes all of the following categories EXCEPT 126) _____

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

127) The statement of cash flows provides a summary of the firm's 127) _____

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

128) All of the following are sources of cash EXCEPT 128) _____

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

129) All of the following are uses of cash EXCEPT 129) _____

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

130) Three important inputs to the statement of cash flows must be obtained from an income statement for the period of concern. These inputs are all of the following EXCEPT 130) _____

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

131) Cash flows directly related to production and sale of the firm's products and services are called 131) _____

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

132) Cash flows associated with purchase and sale of both fixed assets and business interests are called 132) _____

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

133) Cash flows that result from debt and equity financing transactions, including incurrence and repayment of debt, cash inflows from the sale of stock, and cash outflows to pay cash dividends or repurchase stock are called 133) _____

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

134) Johnson, Inc. has just ended the calendar year making a sale in the amount of $10,000 of merchandise purchased during the year at a total cost of $7,000. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The net profit and cash flow for the year are 134) _____

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

D) $3,000 and $7,000 respectively.

135) A firm has just ended the calendar year making a sale in the amount of $150,000 of merchandise purchased during the year at a total cost of $112,500. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. The net profit and cash flow for the year are 135) _____

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

FIGURE 2.2

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

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

Net profits after taxes for 2003: $150.00

136) The primary source of funds for the firm in 2003 is (See Figure 2.2) 136) _____

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

137) Common stock dividends paid in 2003 amounted to ________. (See Figure 2.2) 137) _____

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

138) The firm may have increased long-term debts to finance (See Figure 2.2) 138) _____
A) an increase in gross fixed assets.
B) an increase in current assets, an increase in gross fixed assets, and a decrease in notes payable.
C) a decrease in notes payable.
D) an increase in current assets.

139) Sources of funds for 2003 totaled ________. (See Figure 2.2) 139) _____
A) $950 B) $800 C) $700 D) $600

140) The firm ________ fixed assets worth ________. (See Figure 2.2) 140) _____
A) sold; $200 B) purchased; $0
C) sold; $0 D) purchased; $200

141) The firm's cash flow from operations is ________. (See Figure 2.2) 141) _____
A) $150 B) $350 C) $300 D) $950

142) Use of funds for 2003 totaled ________. (See Figure 2.2) 142) _____
A) $800 B) $950 C) $600 D) $700

143) The smallest use of funds for the firm in 2003 is (See Figure 2.2) 143) _____
A) a decrease in notes payable.
B) dividends.
C) a decrease in long-term debts.
D) an increase in inventory.

144) The amortization expense for 2003 is ________. (See Figure 2.2) 144) _____
A) $1,000 B) $50 C) $200 D) $0

145) A corporation sold a fixed asset for $100,000, which was also its book value. This is 145) _____
A) an operating cash flow and a source of funds.
B) an operating cash flow and a use of funds.
C) an investment cash flow and a source of funds.
D) an investment cash flow and a use of funds.

146) A corporation raises $500,000 in long-term debt to acquire additional plant capacity. This is considered 146) _____
A) a financing cash flow.
B) a financing cash flow and operating cash flow, respectively.
C) a financing cash flow and investment cash flow, respectively.
D) an investment cash flow.

147) All of the following are financing cash flows EXCEPT 147) _____
A) increasing debt. B) sale of stock.
C) repurchasing stock. D) payment of stock dividends.

148) All of the following are operating cash flows EXCEPT 148) _____
A) net income after taxes.
B) amortization expense.
C) an increase or decrease in fixed assets.
D) an increase or decrease in current liabilities.

149) For the year ended December 31, 2003, a corporation had cash flow from operating activities of -$10,000, cash flow from investment activities of $4,000, and cash flow from financing activities of $9,000. The Statement of Cash Flows would show a 149) _____

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

150) For the year ended December 31, 2003, a corporation had cash flow from operating activities of $20,000, cash flow from investment activities of -$15,000, and cash flow from financing activities of -$10,000. The Statement of Cash Flows would show a 150) _____

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

151) For the year ended December 31, 2003, a corporation had cash flow from operating activities of $12,000, cash flow from investment activities of -$10,000, and cash flow from financing activities of $4,000. The Statement of Cash Flows would show a 151) _____

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

152) A firm has just ended the calendar year making a sale in the amount of $200,000 of merchandise purchased during the year at a total cost of $150,500. Although the firm paid in full for the merchandise during the year, it has yet to collect at year end from the customer. One possible problem this firm may face is 152) _____

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

153) Capital cost allowance is 153) _____

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

154) Which of the following is a noncash expense added back to net income in determining cash flow from operating activities? 154) _____

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

155) The after-tax cost of a $40 can of paint to a company with a marginal tax rate of 40% is 155) _____

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

156) Capital losses can be 156) _____
A) written off against only capital gains.
B) cannot be written off at all.
C) written off against all sources of income.
D) written off against only ordinary income.

157) The small business deduction for eligible Canadian-controlled private corporations is 157) _____
A) 7%. B) 28%. C) 44%. D) 16%.

158) Corporate taxes are paid through 158) _____
A) lower returns to the investor.
B) lower wages to workers.
C) higher prices to the consumer.
D) all of the above.

159) The portion of the annual report where management provides analysis and explains the financial results is the 159) _____
A) auditors note to shareholders.
B) letter to shareholders.
C) management's discussion and analysis.
D) all of the above

160) The cost of capital 160) _____
A) provides a hurdle for management in making capital budgeting decisions.
B) measures the riskiness of a project or firm.
C) depends on the type of assets being invested in.
D) all of the above

161) Capital budgeting is 161) _____
A) necessary whenever an executive wants to determine how to report earnings on the financial statements.
B) the methods used to value a real project.
C) the methods used to determine a firm's hurdle rate for new projects.
D) not related to finance, but rather a marketing term.

162) Dividends paid to a Canadian corporation by a Canadian corporation are 162) _____
A) taxed at 50% of the marginal tax rate.
B) exempt from tax.
C) taxed as ordinary income.
D) grossed up by 25% before calculating taxes and the dividend tax credit.

163) In Canada, the Board of Directors are generally 163) _____
A) women.
B) selected from a small group of inter-related people.
C) politicians or an appointee.
D) Aboriginal leaders and elders.

164) Since financial decisions usually involve new cash flows or changes in existing ones, the relevant tax rate is the 164) _____

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

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

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

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

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

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

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

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

Calculate:

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

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

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

income earned by Bradshaw Corporation during 2002?

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

171) A corporation has the following record of earnings for the years 1996 through 2002.
a. Indicate the carryback/carryforward amounts.
b. Calculate the tax refund in 2001 if their tax rate during this time period has been 40 percent.
c. Indicate the carryforward, the taxable earnings, and tax liability for 2002.

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

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

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

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

174) Given the financial data for New Electronic World, Inc. (NEW), compute the following measures of cash flows for the NEW for the year ended December 31, 2003.
A. Operating Cash Flow.
B. Free Cash Flow.

	For the year ended December 31, 2002	2003
Depreciation		$3,000
EBIT		30,000
Interest expenses		3,000

Taxes	45,000			8,000	
Cash	Inventory	$21,000	27,000	24,000	30,000
Accounts	Net fixed assets		22,000		24,000
Receivab	Accounts payable		25,000		30,000
le	Notes payable		50,000		40,000
3	Accruals		1,000		2,000
9,000					

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

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

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

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

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

FIGURE 2.3

Magna Fax, Inc.
Income Statement

For the Year Ended December 31, 2003

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

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

Operating profits	$ 20,000
Interest expense	2,500

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

Net income after taxes	$ 10,500

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

Assets		2003		2002
Cash		$24,000		$21,000
Accounts receivable		45,000		39,000
Inventory		30,000		27,000
Gross fixed assets	$42,000		$40,000	
Acc. amortization	22,000		18,000	
Net fixed assets		20,000		22,000
		--------		--------
Total assets		$119,000		$109,000

Liabilities and Equity		
Accounts payable	$25,000	$30,000
Notes payable	50,000	40,000
Accruals	1,000	2,000
Long-term debts	10,000	8,000
Common stock at par	5,000	5,000
Retained earnings	28,000	24,000
	--------	--------
Total liabilities and equity	$119,000	$109,000

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

a. Prepare a statement of retained earnings for the year ended December 31, 2003.

b. Prepare a statement of cash flows for the year ended December 31, 2003, organized by sources of cash and uses of cash.

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

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

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

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

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

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

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

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

Total Expenses	275,000
EBIT	$150,000
Interest Expense	15,000

EBT	$135,000
Taxes	27,000

Net Income after taxes	$108,000

Note: Amortization Expense = $10,400

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

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

Total less: Dividends Declared and Paid

Retained Earnings, December 31, 2003

ABC confectionery Limited
Balance Sheet
December 31, 2003

	2003	2002
Assets		
Current Assets:		
Cash	$ 36,900	$ 16,000
Accounts Receivable	6,000	4,000
Inventory	44,000	50,000
Prepaid Expenses	2,000	2,000
	-------	-------
Total Current		

Assets	$12,800 $88,900	$ 72,000
Fixed Assets:		
Fixtures and Equipment	$ 90,000	$ 80,000
less: Accumulated Amortization	(68,000)	(60,000)
Building	120,000 12,000	120,000
less: Accumulated Amortization	(62,400)	(60,000)
Net Building	57,600	60,000
	-------	-------
Total Fixed Assets	$ 79,600	$ 80,000
	$ 8,000 -------	-------
Total Assets	$168,500	$152,000
Liabilities		
Current Liabilities:		
Accounts Payable	$ 22,500	$ 15,000
Interest Payable	3,000	4,000
Taxes Payable	40,000	8,000
	-------	-------
Total Current Liabilities	$ 65,500	$ 27,000
Long-term Liabilities:		
Business Loan	$ 25,000	$ 35,000
Mortgage on Building	57,500	60,000
	-------	--------
Total Long-term Liabilities	$ 82,500	$ 95,000
	-------	--------
Total Liabilities	$148,000	$122,000
Shareholders' Equity:		
Common Shares	$ 12,500	$ 10,000
Retained Earnings	8,000	20,000
	-------	-------
Total Shareholders' Equity	$ 20,500	$ 30,000
	-------	-------
Total Liab. and Shareholder's Equity	$168,500	$152,000

1) FALSE
2) TRUE
3) FALSE
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10) TRUE
11) TRUE
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92) A
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98) C
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101) C
102) A
103) B

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105) C
106) A
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137) B
138) B
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143) B
144) C
145) C
146) C
147) D
148) C
149) A
150) B
151) A
152) B
153) D
154) A
155) C

156) A
157) D
158) D
159) C
160) D
161) B
162) B
163) B
164) C
165)

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

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

Earnings after taxes	$294,000

166) a.

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

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

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

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

Earnings Available for Common Stock	$ 314,000

b.

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

Increased Retained Earnings	$ 250,250

167) a.

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

b.

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

Operating profits		$18,500

c.

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

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

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

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

g.
earnings available for C.S. $8,500
----------------------- = -------- = $1.70/share
# of common shares outstanding 5,000

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

Net Profits After Taxes $261,960

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

Dividends = $210,960

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

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

Net Profits After Taxes = $202,500

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

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

171) a.

Taxable Cumulative Adjusted

Year 2001 Earnings -1,500,000 CB/CF Earnings
1996 2002 500,000 200,000 1,500,000 0
$
400,0 b. Tax refund in 2001:
00 ($1,300,000)(0.40) = $520,000 $
1997 500,000
1998 c. Carryforward to 2002: 600,000 600,000 600,000 = $200,000
1999 Taxable earnings: 400,000 400,000 $500,000 - $200,000 1,000,000 0 = $300,000
2000 Tax liability: 300,000 300,000 ($300,000)(0.40) 1,300,000 0 = $120,000

172) Asset Tax Liability

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

173) Depreciation Schedule

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

174) a. OCF = EBIT - Taxes + Depreciation

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

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

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

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

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

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

176) ABC Corp.

Balance Sheet Changes and Classification of Key Accounts between 2002 and 2003

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

177) a.

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

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

b.

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

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

c.

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

Cash flow from operating activities:

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

Cash flow from investment activities:

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

Cash flow from financing activities:	Inc. in Notes payable	$10,000	
	Inc. in LT debts	2,000	
	Changes in S.E.	0	
	Dividends paid	- 6,500	
		--------	$5,500

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

178) 1) The historical cost principle is objective and conservative, but does not reflect market realities.

2) Items like goodwill, human capital, competitive advantages, and growth options are not accounted for in the financial statements.

179)

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

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

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

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

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

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

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

Net Increase in Cash	$ 20,900