Question #1 of 98

Question ID: 1457484

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

	Direct Method	Indirect Method
A)	Considers	Considers
B)	Does not consider	Considers
C)	Does not consider	Does not consider

Explanation

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

(Module 20.2, LOS 20.f)

Question #2 of 98

Question ID: 1457503

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

A) add decreases in accounts receivables to net sales.

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

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

Explanation

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

(Module 20.3, LOS 20.g)

Question #3 of 98

Question ID: 1457422

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

A) Change in long-term debt.

B) Change in retained earnings.

C) Dividends paid.

Explanation

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

(Module 20.1, LOS 20.a)

Question #4 of 98

Question ID: 1462823

From Thorpe Company's cash flow statement, an analyst discovers that during the most recent period Thorpe spent $2 million on what the firm describes as "investment in capital improvements." If the analyst believes this expenditure will not give Thorpe any enduring benefit beyond the current period, the *most appropriate* adjustment is to:

A) decrease CFO and increase CFI.

B) increase CFO and decrease CFI.

C) decrease both CFO and CFI.

Explanation

The analyst believes an expenditure the firm classified as an investing cash outflow should have been classified as an operating cash outflow. Thus, the analyst should adjust CFO downward and CFI upward. (Module 20.1, LOS 20.a)

Question #5 of 98

Question ID: 1457461

To calculate cash received from customers, an analyst would *most appropriately*:

A) add the change in accounts receivable to credit sales.

B) subtract accounts receivable from gross sales.

C) subtract the change in accounts receivable from net sales.

Explanation

Cash received from customers is most appropriately calculated by subtracting the change in accounts receivable from net sales.

(Module 20.1, LOS 20.e)

Question #6 of 98

Question ID: 1457439

The sale of obsolete equipment would be classified as:

A) financing cash flow.

B) investing cash flow.

C) operating cash flow.

Explanation

The sale of equipment is classified as investing cash flow.

(Module 20.1, LOS 20.a)

Question #7 of 98

Question ID: 1457417

Under U.S. GAAP, the actual coupon payment on a bond is reported on the statement of cash flow as:

A) a financing cash outflow.

B) an investing cash outflow.

C) an operating cash outflow.

Explanation

The coupon payment is recorded on the statement of cash flows as an operating cash outflow under U.S. GAAP.

(Module 20.1, LOS 20.a)

Question #8 of 98

Question ID: 1457476

A U.S. GAAP reporting company has the following changes in its balance sheet accounts:

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

The company's cash flow from financing is:

A) $100.

B) -$10.

C) $90.

Explanation

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

(Module 20.2, LOS 20.f)

Question #9 of 98

Question ID: 1457464

Darth Corporation's net income was $1,200 in the most recent period. Its depreciation expense was $800 and its accounts receivable increased by $1,000. Based only on this information, cash flow from operating activities reported by Darth should be:

A) $1,200.

B) $2,200.

C) $1,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #10 of 98

Question ID: 1457450

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

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

Explanation

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

(Module 20.1, LOS 20.c)

Question #11 of 98

Question ID: 1457481

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

A) either the direct or indirect methods.

B) the direct method.

C) the indirect method.

Explanation

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

(Module 20.2, LOS 20.f)

Question #12 of 98

Question ID: 1457497

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

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

During the year:

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

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

A) $4,800,000.

B) $5,900,000.

C) $4,400,000.

Explanation

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

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

(Module 20.2, LOS 20.f)

Question #13 of 98

Question ID: 1462822

Which of the following statements about cash flow is *least accurate*? Under U.S. GAAP, cash flow from:

A) investing includes interest income from investment in debt securities.

B) financing includes the proceeds of debt issued and from the sale of the company's common stock.

C) operations includes cash operating expenses and changes in working capital accounts.

Explanation

Interest income is considered an operating cash flow under U.S. GAAP. (Module 20.1, LOS 20.a)

Question #14 of 98

Question ID: 1457489

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

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

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

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

Explanation

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

(Module 20.2, LOS 20.f)

Question #15 of 98

Question ID: 1457469

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

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

A) -$95.

B) -$50.

C) +$105.

Explanation

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

(Module 20.2, LOS 20.f)

Question #16 of 98

Question ID: 1457418

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

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

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

	Investing Activities	Financing Activities
A)	$170,000	$37,000
B)	$178,000	-$37,000
C)	$170,000	-$38,000

Explanation

Investing Activities:

$10,000 – $180,000 = -$170,000 cash flow from investing or $170,000 used

Financing Activities:

$38,000 – $75,000 = -$37,000 cash flow from financing or $37,000 used

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

(Module 20.1, LOS 20.a)

Question #17 of 98

Question ID: 1457482

Juniper Corp. has the following transactions in 20X5.

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

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

A) –$100,000.

B) –$115,000.

C) –$60,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #18 of 98

Question ID: 1457423

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

A) Dividends received by Elegant, Inc. from an investment in another firm.

B) Elegant's payment to purchase equipment to be used in its business.

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

Explanation

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

(Module 20.1, LOS 20.a)

Question #19 of 98

Question ID: 1457486

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

Beeline Company Balance Sheet As of December 31, 20X4					
	2003	*2004*		*2003*	*2004*
Cash	$50	$60	Accounts payable	$100	$150
Accounts receivable	100	110	Long-term debt	400	300
Inventory	200	180	Common stock	50	50
			Retained earnings	400	500
Fixed assets (gross)	800	900	Total liabilities and equity	$950	$1,000
Less: Accumulated depreciation	200	250			
Fixed assets (net)	600	650			
Total assets	$950	$1,000			

Beeline Company Income Statement For year ended December 31, 20X4	
Sales	$1,000
Less:	
COGS	600
Depreciation	50
Selling, general, and administrative expenses	160
Interest expense	23
Income before taxes	$167
Less tax	67
Net income	$100

The cash flow from operations for 2004 is:

A) $210.

B) $260.

C) $150.

Explanation

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

(Module 20.2, LOS 20.f)

Question #20 of 98

Question ID: 1457457

Consider the following:

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

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

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

A) Argument #1 only.

B) Argument #2 only.

C) Neither argument.

Explanation

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

(Module 20.1, LOS 20.d)

Question #21 of 98

Question ID: 1457437

An increase in notes payable would be classified as:

A) financing cash flow.

B) having no cash flow impact.

C) investing cash flow.

Explanation

An increase in notes payable is classified as financing cash flow.

(Module 20.1, LOS 20.a)

Question #22 of 98

Question ID: 1457452

Fricks Ltd. is a gold mining company headquartered in Indonesia with operations throughout the world. Fricks reports under IFRS. When subsidiaries located in the United States and Canada pay dividends to the Indonesian parent company, Fricks may classify the dividends as:

A) cash flow from either investing or operations.

B) cash flow from financing only.

C) cash flow from investing only.

Explanation

Under IFRS, interest and dividends received may be shown as either cash flow from operations or cash flow from investing.

(Module 20.1, LOS 20.c)

Question #23 of 98

Question ID: 1457478

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

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

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

A) $4,600,000.

B) $4,200,000.

C) $4,500,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #24 of 98

Question ID: 1457456

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

Revenue	$100,000
Cost of goods sold	(40,000)
Cash operating expenses	(20,000)
Depreciation expense	(5,000)
Tax expense	(3,000)
Net income	$32,000
Increase in accounts receivable	$7,500
Decrease in inventory	$2,500
Increase in short-term notes payable	$3,000
Decrease in accounts payable	$1,000

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

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

Explanation

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

(Module 20.1, LOS 20.d)

Question #25 of 98

Question ID: 1457473

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

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

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

A) $15.

B) $23.

C) $27.

Explanation

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

(Module 20.2, LOS 20.f)

Question #26 of 98

Question ID: 1457487

An analyst has gathered the following information about a company:

Income Statement for the Year 20X5		
Sales		$1,500
Expenses		
COGS	$1,300	
Depreciation	20	
Goodwill	10	
Int. Expenses	40	
Total expenses		1,370
Income from cont. op.		130
Gain on sale		30
Income before tax		160
Income tax		64
Net Income		$96

Additional Information:

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

What is the cash flow from investing?

A) $10.

B) $110.

C) $130.

Explanation

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

(Module 20.2, LOS 20.f)

Question #27 of 98

Question ID: 1457472

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

Sales revenue	$200,000
Wage expense	89,000
Insurance expense	17,000
Interest expense	10,400
Depreciation expense	50,000

Following are the related balance sheet accounts:

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

Calculate cash collections and cash expenses.

	Cash collections	Cash expenses
A)	$202,400	$58,100
B)	$202,400	$119,900

C) $197,600 $119,900

Explanation

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

(Module 20.2, LOS 20.f)

Question #28 of 98

Question ID: 1457426

Under US GAAP, which of the following is NOT a cash flow from operation?

A) dividends paid to shareholders.

B) dividends received.

C) interest payments.

Explanation

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

(Module 20.1, LOS 20.a)

Question #29 of 98

Question ID: 1457425

Holden Company's fixed asset footnote included the following:

- During 20X7, Holden sold machinery for a gain of $100,000. The machinery had an original cost of $500,000 and its accumulated depreciation was $240,000.
- At the end of 20X7, Holden purchased machinery at a cost of $1,000,000. Holden paid $400,000 cash. The balance was financed by the seller at 8% interest.
- Depreciation expense was $2,080,000 for the year ended 20X7.

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

A) $300,000 outflow.

B) $360,000 inflow.

C) $40,000 outflow.

Explanation

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

(Module 20.1, LOS 20.a)

Question #30 of 98

Question ID: 1457451

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

A) either IFRS or U.S. GAAP.

B) IFRS but not under U.S. GAAP.

C) U.S. GAAP but not under IFRS.

Explanation

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

(Module 20.1, LOS 20.c)

Question #31 of 98

Question ID: 1457510

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

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

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

A) 0.50.

B) 0.75.

C) 1.00.

Explanation

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

(Module 20.4, LOS 20.i)

Question #32 of 98

Question ID: 1457463

Use the following financial data for Moose Printing Corporation, a U.S. GAAP reporting firm, to calculate the cash flow from operations (CFO) using the indirect method.

- Net income: $225
- Increase in accounts receivable: $55
- Decrease in inventory: $33
- Depreciation: $65
- Decrease in accounts payable: $25
- Increase in wages payable: $15
- Decrease in deferred taxes: $10
- Purchase of new equipment: $65
- Dividends paid: $75

A) Increase in cash of $183.

B) Increase in cash of $248.

C) Increase in cash of $173.

Explanation

CFO for Moose Printing Corporation is calculated as follows:

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

The purchase of new equipment is an investing activity and therefore is not included in CFO. Dividends paid is a financing activity and is not included in CFO.

(Module 20.2, LOS 20.f)

Question #33 of 98

Question ID: 1457477

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

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

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

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

Explanation

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

The other statements are accurate:

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

(Module 20.2, LOS 20.f)

Question #34 of 98

Question ID: 1457485

An analyst has gathered the following information about a company:

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

Additional Information:

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

What is the cash flow from operations?

A) $170.

B) $156.

C) $150.

Explanation

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

(Module 20.2, LOS 20.f)

Question #35 of 98

Question ID: 1457428

Under U.S. GAAP, which of the following *least likely* represents a cash flow relating to operating activity?

A) Cash received from customers. ✗

B) Dividends paid to stockholders. ✓

C) Interest paid to bondholders. ✗

Explanation

U.S. GAAP requires dividends paid to stockholders to be classified as cash flow relating to financing activity, and interest paid to bondholders to be classified an operating activity.

(Module 20.1, LOS 20.a)

Question #36 of 98

Question ID: 1457453

A company prepares its financial statements under International Financial Reporting Standards. The company's cash flow statement will classify interest paid as either an:

A) operating or investing cash flow. ✗

B) investing or financing cash flow. ✗

C) operating or financing cash flow. ✓

Explanation

IFRS allows interest paid to be reported in either the operating or financing section of the cash flow statement. U.S. GAAP requires interest paid to be reported in the operating section of the cash flow statement.

(Module 20.1, LOS 20.c)

Question #37 of 98

Question ID: 1457434

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

A) Financing.

B) Investing.

C) Operating.

Explanation

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

(Module 20.1, LOS 20.a)

Question #38 of 98

Question ID: 1462826

Copper, Inc., had $4 million in bonds outstanding that were convertible into common stock at a conversion rate of 100 shares per $1,000 bond. In 20X1, all of the outstanding bonds were converted into common stock. Copper's average share price for 20X1 was $15. Copper's statement of cash flows for the year ended December 31, 20X1, should *most likely* include:

A) cash flows from financing of +$4 million from issuance of common stock and –$4 million from retirement of bonds.

B) cash flows from financing of +$6 million from issuance of common stock and –$4 million from retirement of bonds and cash flows from investing of –$2 million for a loss on retirement of bonds.

C) a footnote describing the conversion of the bonds into common stock.

Explanation

Conversion of bonds into common stock is a non-cash transaction, but the conversion should be disclosed in a footnote to the statement of cash flows. (Module 20.2, LOS 20.f)

Question #39 of 98

Question ID: 1457511

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

A) $15 million. ✗

B) $18 million. ✓

C) $22 million. ✗

Explanation

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

(Module 20.4, LOS 20.i)

Question #40 of 98

Question ID: 1457433

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

	Operating liabilities	Financing liabilities	
A)	Accounts payable	Current portion of long-term debt	✓
B)	Customer advances	Accrued liabilities	✗
C)	Short-term note payable	Current portion of long-term debt	✗

Explanation

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

(Module 20.1, LOS 20.a)

Question #41 of 98

Question ID: 1457458

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

A) always equal to zero.

B) disclosed as a reserve in the footnotes to the cash flow statement.

C) balanced by an opposite difference in cash flow from investing.

Explanation

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

(Module 20.1, LOS 20.d)

Question #42 of 98

Question ID: 1457491

Determine the cash flow from financing given the following table.

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

A) -$5.

B) $15.

C) $20.

Explanation

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

(Module 20.2, LOS 20.f)

Question #43 of 98

Question ID: 1457508

A common-size cash flow statement is *least likely* to provide payments to employees as a percentage of:

A) total cash outflows for the period.

B) operating cash flow for the period.

C) revenues for the period.

Explanation

There are two formats for a common-size cash flow statement, expressing each type of outflow as a percentage of total cash outflows or as a percentage of total revenue for the period. Operating cash flow for the period mixes inflows and outflows and is not used to calculate percentage flows for payment made.

(Module 20.3, LOS 20.h)

Question #44 of 98

Question ID: 1457465

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

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

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

A) $8,000,000.

B) $11,000,000.

C) $13,000,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #45 of 98

Question ID: 1462825

Under IFRS, which cash flow statement classifications for dividends paid and interest received, respectively, are *least likely* permitted?

	Dividends paid	Interest received
A)	Operating activity	Investing activity
B)	Financing activity	Operating activity
C)	Investing activity	Financing activity

Explanation

Under IFRS, interest received may be classified as CFO or CFI, while dividends paid may be classified as CFO or CFF. (Module 20.1, LOS 20.c)

Question #46 of 98

Question ID: 1462827

How will a firm's operating cash flow be affected by a decrease in accounts receivable and by an increase in accounts payable?

A) One will increase operating cash flow and one will decrease operating cash flow.

B) Both will increase operating cash flow.

C) Both will decrease operating cash flow.

Explanation

A decrease in the accounts receivable amount on the balance sheet indicates that cash collections exceed revenues (sales). This increases operating cash flow because receivables are being collected. An increase in the accounts payable amount on the balance sheet indicates that purchases from suppliers exceed cash payments. This increases operating cash flow because the cash was not used to pay the suppliers. (Module 20.2, LOS 20.f)

Question #47 of 98

Question ID: 1457475

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

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

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

C) The indirect method requires an additional schedule to reconcile net income to cash flow.

Explanation

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

(Module 20.2, LOS 20.f)

Question #48 of 98

Question ID: 1457483

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

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

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

A) $6,300,000.

B) $4,300,000.

C) $5,300,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #49 of 98

Question ID: 1457446

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

A) Principal payments received from loans made to others.

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

C) Sale of held-to-maturity securities for cash.

Explanation

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

(Module 20.1, LOS 20.b)

Question #50 of 98

Question ID: 1457459

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

A) Equity and non-current liabilities.

B) Non-current assets.

C) Working capital.

Explanation

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

(Module 20.1, LOS 20.e)

Question #51 of 98

Question ID: 1457488

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

A) Net income. ✓

B) Payment of dividends. ✗

C) Investment in Property, Plant, & Equipment. ✗

Explanation

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

(Module 20.2, LOS 20.f)

Question #52 of 98

Question ID: 1457447

How would a stock split *most likely* be reported on the statement of cash flows?

A) Reported in cash flows from financing. ✗

B) Disclosed in the footnotes. ✓

C) Reported in cash flows from operations. ✗

Explanation

No cash changes hands in a stock split. If a stock split is mentioned in the statement of cash flows, it will be disclosed in the footnotes as a noncash transaction.

(Module 20.1, LOS 20.b)

Question #53 of 98

Question ID: 1457512

Joplin Corporation reports the following in its year-end financial statements:

- Net income of $43.7 million.
- Depreciation expense of $4.2 million.
- Increase in accounts receivable of $1.5 million.
- Decrease in accounts payable of $2.3 million.
- Sold equipment for $15 million.
- Purchased equipment for $35 million.

Joplin's free cash flow to the firm (FCFF) is closest to:

A) $28 million.

B) $39 million.

C) $24 million.

Explanation

Free cash flow to the firm = net income + noncash charges + after-tax interest – fixed capital investment – working capital investment.

Net income is $43.7 million.

Noncash charges are $4.2 million (depreciation expense).

No interest expense is shown.

Fixed capital investment is $35 million purchased – $15 million sold = $20 million.

Working capital investment is $1.5 million increase in accounts receivable + $2.3 million decrease in accounts payable = $3.8 million. (Both are uses of cash)

FCFF = $43.7 million + $4.2 million – $20 million – $3.8 million = $24.1 million.

(Module 20.4, LOS 20.i)

Question #54 of 98

Question ID: 1457427

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

A) Investing.

B) Operating.

C) Financing.

Explanation

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

(Module 20.1, LOS 20.a)

Question #55 of 98

Question ID: 1457460

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

A) Financing cash flows.

B) Investing cash flows.

C) Operating cash flows.

Explanation

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

(Module 20.1, LOS 20.e)

Question #56 of 98

Question ID: 1457492

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

A) $1,200.

B) $1,300.

C) $1,800.

Explanation

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

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

(Module 20.2, LOS 20.f)

Question #57 of 98

Question ID: 1457449

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

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

Explanation

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

(Module 20.1, LOS 20.c)

Question #58 of 98

Question ID: 1457504

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

A) increase cost of goods sold by any depreciation that was included. ✗

B) reduce cost of goods sold by any decreases in accounts payable. ✗

C) reduce cost of goods sold by any decreases in inventory. ✓

Explanation

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

(Module 20.3, LOS 20.g)

Question #59 of 98

Question ID: 1457444

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

- Issued 5,000 shares of preferred stock for land with a fair value of $4.8 million.
- Purchased a patent for $3.3 million cash.
- Acquired 40% of the common stock of an affiliate for $2.7 million cash which was borrowed from a bank.
- Exchanged equipment with a book value of $1.7 million for equipment valued at $2.1 million. The exchange was an even trade.
- Converted bonds payable with a book value of $5 million to 50,000 shares of common stock with a fair value of $6 million.

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

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

C) $2.7 million outflow $6.0 million inflow

Explanation

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

(Module 20.1, LOS 20.b)

Question #60 of 98

Question ID: 1457419

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

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

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

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

Explanation

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

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

(Module 20.1, LOS 20.a)

Question #61 of 98

Question ID: 1457490

Determine the cash flow from operations given the following table.

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

A) $45.

B) $35.

C) $20.

Explanation

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

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

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

(Module 20.2, LOS 20.f)

Question #62 of 98

Question ID: 1457462

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

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

A) Increase in cash of $10,500. ✔

B) Increase in cash of $7,500. ✘

C) Increase in cash of $9,500. ✘

Explanation

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

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

(Module 20.2, LOS 20.f)

Question #63 of 98

Question ID: 1457502

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

<u>Cash collections from customers:</u>   <u>Cash payments to suppliers</u>

A)	Subtract decrease in unearned revenue	Subtract an inventory writedown	✔
B)	Add decrease in unearned revenue	Subtract an inventory writedown	✘
C)	Subtract decrease in unearned revenue	Add an inventory writedown	✘

Explanation

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

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

(Module 20.3, LOS 20.g)

Question #64 of 98

Question ID: 1457468

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

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

B) A positive (negative) adjustment to net income when accounts payable increases (decreases). ✔

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

Explanation

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

(Module 20.2, LOS 20.f)

Question #65 of 98

Question ID: 1457474

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

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

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

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

A) $29.

B) $37.

C) $41.

Explanation

Using the indirect method:

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

(Module 20.2, LOS 20.f)

Question #66 of 98

Question ID: 1457440

Depreciation expense would be classified as:

A) having no cash flow impact.

B) investing cash flow.

C) operating cash flow.

Explanation

Depreciation expense has no cash flow impact.

(Module 20.1, LOS 20.a)

Question #67 of 98

Question ID: 1457467

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

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

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

A) $1,050,000.

B) $1,000,000.

C) $1,015,000.

Explanation

Cash flow from operations (CFO) using the indirect method is computed by taking net income plus non-cash expenses (i.e. depreciation) less gains from the equipment sale. Note that cash flow from operations must be adjusted downward for the amount of the gain on the sale of the equipment. Cash flow from operations is ($850,000 + $200,000 – ($100,000 – $50,000)) = $1,000,000. The other information relates to financing cash flows.

(Module 20.2, LOS 20.f)

Question #68 of 98

Question ID: 1457430

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

A) Buying or selling a building.

B) Proceeds related to acquisitions.

C) Selling stock of the company.

Explanation

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

(Module 20.1, LOS 20.a)

Question #69 of 98

Question ID: 1457448

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

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

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

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

Explanation

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

(Module 20.1, LOS 20.c)

Question #70 of 98

Question ID: 1462824

At the end of 20X8, Wichita, Inc., purchased equipment totaling $500,000. The seller of the equipment provided 100% debt financing with payments, including interest, that begin in 20X9. How does the equipment purchase affect Wichita's 20X8 cash flows?

A) No effect.

B) Decrease cash flow from operations.

C) Decrease cash flow from investment.

Explanation

The seller financing is a noncash transaction. Accordingly, Wichita's 20X8 cash flows are unaffected. The noncash transaction should be disclosed in the footnotes to the 20X8 cash flow statement. (Module 20.1, LOS 20.a)

Question #71 of 98

Question ID: 1457496

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

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

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

A) –$1,045,000.

B) –$45,000.

C) –$95,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #72 of 98

Question ID: 1457470

Impala Corporation reported the following financial information:

	2006	2007
Balance sheet values as of December 31:		
Prepaid insurance	$650,000	$475,000
Interest payable	250,000	300,000
Cash flows for the year ended December 31:		
Insurance premiums paid	$845,000	$750,000
Interest paid	900,000	900,000

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

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

Explanation

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

(Module 20.2, LOS 20.f)

Question #73 of 98

Question ID: 1457424

Which of the following transactions is *least likely* to be classified as cash flow from investing?

A) Dividends paid.

B) Land sold.

C) Equipment purchased.

Explanation

Under U.S. GAAP, dividends paid are classified as financing cash flows. Under IFRS, dividends paid may be classified as operating or financing cash flows. Purchases and sales of long-lived assets such as equipment or land are examples of investing cash flows.

(Module 20.1, LOS 20.a)

Question #74 of 98

Question ID: 1457455

Which set of accounting standards allows a firm to classify interest received as a financing cash flow and interest paid as an investing cash flow on its cash flow statement?

A) U.S. GAAP only.

B) The IFRS only.

C) Neither the IFRS nor U.S. GAAP.

Explanation

The IFRS allows a firm to classify interest received as either operating or *investing* cash flow and to classify interest paid as either operating or *financing* cash flow. U.S. GAAP requires that interest received and paid both be classified as operating cash flows.

(Module 20.1, LOS 20.c)

Question #75 of 98

Question ID: 1457421

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

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

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

A) -$300.

B) $11,200.

C) -$1,300.

Explanation

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

(Module 20.1, LOS 20.a)

Question #76 of 98

Question ID: 1457438

Under U.S. GAAP, interest paid would be classified as:

A) financing cash flow.

B) operating cash flow.

C) having no cash flow impact.

Explanation

Interest paid is classified as operating cash flow under U.S. GAAP.

(Module 20.1, LOS 20.a)

Question #77 of 98

Question ID: 1462829

David Chance, CFA, is analyzing Grow Corporation. Chance gathers the following information:

Net cash provided by operating activities	$3,500
Net cash used for fixed capital investments	$727
Cash paid for interest	$195
Income before tax	$4,400
Income tax expense	$1,540
Net income	$2,860

Grow's free cash flow to the firm (FCFF) is *closest* to:

A) $2,260.

B) $2,900.

C) $2,640.

Explanation

$$\text{FCFF} \quad = \text{CFO} + \text{Int}(1 - \text{tax rate}) - \text{capital expenditures}$$

$$\text{FCFF} \quad = 3{,}500 + \left[195 \times \left(1 - \left(\frac{1{,}540}{4{,}400}\right)\right)\right] - 727 = 2{,}899.75 \approx 2{,}900$$

(Module 20.4, LOS 20.i)

Question #78 of 98

Question ID: 1457429

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

A) Dividends received.

B) Dividends paid.

C) Interest paid.

Explanation

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

(Module 20.1, LOS 20.a)

Question #79 of 98

Question ID: 1457480

Determine the cash flow from investing given the following table:

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

A) $10.

B) -$5.

C) -$10.

Explanation

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

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

(Module 20.2, LOS 20.f)

Question #80 of 98

Question ID: 1462830

A common-size cash flow statement is *least likely* to show each cash inflow as a percentage of:

A) revenue.

B) all cash inflows.

C) total cash flows.

Explanation

Common-size cash flow statements show each cash flow item as a percentage of revenue or show each cash flow outflow as a percentage of all cash outflows and each cash inflow as a percentage of all cash inflows. (Module 20.4, LOS 20.i)

Question #81 of 98

Question ID: 1457495

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

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

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

A) $6,750,000.

B) $9,750,000.

C) $10,000,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #82 of 98

Question ID: 1457509

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

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

Explanation

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

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

(Module 20.4, LOS 20.i)

Question #83 of 98

Question ID: 1457506

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

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

Explanation

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

(Module 20.3, LOS 20.h)

Question #84 of 98

Question ID: 1457493

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

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

Additional Information:

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

What is the cash flow from financing?

A) $70.

B) $110.

C) $130.

Explanation

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

(Module 20.2, LOS 20.f)

Question #85 of 98

Question ID: 1457507

Consider the following:

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

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

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

A) Only statement #2 is correct. ✗

B) Both statements are correct. ✓

C) Only statement #1 is correct. ✗

Explanation

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

(Module 20.3, LOS 20.h)

Question #86 of 98

Question ID: 1457436

Under U.S. GAAP, taxes paid are classified in the statement of cash flows:

A) according to the transaction that created the tax liability. ✗

B) as operating cash flow.

C) as having no cash flow impact.

Explanation

Taxes paid are classified as operating cash outflows under U.S. GAAP.

(Module 20.1, LOS 20.a)

Question #87 of 98

Question ID: 1457494

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

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

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

A) $900,000.

B) $1,200,000.

C) $800,000.

Explanation

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

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

(Module 20.2, LOS 20.f)

Question #88 of 98

Question ID: 1457499

A company's financial statement data for the most recent year include the following:

- Net income $100
- Depreciation expense 25
- Purchase of machine 50
- Sale of company trucks 30
- Sale of common stock 45
- Decrease in accounts receivable 10
- Increase in inventory 20
- Issuance of bonds 25
- Increase in accounts payable 15
- Increase in wages payable 10

Based only on these items, cash flow from financing activities is *closest* to:

A) $85.

B) $140.

C) $70.

Explanation

Sale of common stock	45
Issuance of bonds	25
Financing cash flows	$70

(Module 20.2, LOS 20.f)

Question #89 of 98

Question ID: 1457498

Maverick Company reported the following financial information for 2007:

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

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

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

Explanation

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

(Module 20.2, LOS 20.f)

Question #90 of 98

Question ID: 1457471

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

A) Only accounts receivable will increase.

B) Only accounts payable will increase.

C) Both accounts payable and accounts receivable will increase.

Explanation

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

(Module 20.2, LOS 20.f)

Question #91 of 98

Question ID: 1457466

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

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

Balance 5/01/20X5	Account	Balance 5/31/20X5
$2,000	Inventory	$1,750
$1,200	Prepaid exp.	$1,700
$800	Accum. Depr.	$975
$425	Accounts payable	$625
$650	Bonds payable	$550

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

A) Increase in cash of $8,025.

B) Increase in cash of $7,725.

C) Increase in cash of $8,125.

Explanation

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

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

(Module 20.2, LOS 20.f)

Question #92 of 98

Question ID: 1457420

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

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

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

A) -$5,000.

B) $5,000.

C) $6,000.

Explanation

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

(Module 20.1, LOS 20.a)

Question #93 of 98

Question ID: 1457479

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

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

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

A) –$500,000.

B) –$300,000.

C) –$400,000.

Explanation

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

(Module 20.2, LOS 20.f)

Question #94 of 98

Question ID: 1457432

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

A) The current portion of long-term debt.

B) Cash advances from customers.

C) Trade payables.

Explanation

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

(Module 20.1, LOS 20.a)

Question #95 of 98

Question ID: 1457435

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

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

B) cash flow from financing would increase and cash flow from investing would decrease.

C) both cash flow from operations and cash flow from financing would increase.

Explanation

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

(Module 20.1, LOS 20.a)

Question #96 of 98

Question ID: 1462828

To compute cash collections from customers when converting a statement of cash flows from the indirect to the direct method, an analyst begins with:

A) net income and adds back non-cash expenses.

B) sales, subtracts any increase in accounts receivable, and adds any increase in unearned revenue.

C) cost of goods sold, subtracts any increase in accounts payable, adds any increase in inventory, and subtracts any inventory write-offs.

Explanation

To compute cash collections from customers, begin with net sales from the income statement, subtract (add) any increase (decrease) in accounts receivable, and add (subtract) any increase (decrease) in unearned revenue. (Module 20.3, LOS 20.g)

Question #97 of 98

Question ID: 1457445

Dart Corporation engaged in the following transactions earlier this year:

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

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

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

A) Both should be reported as such.

B) Neither should be reported as such.

C) Only one should be reported as such.

Explanation

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

(Module 20.1, LOS 20.b)

Question #98 of 98

Question ID: 1457431

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

A) Gain on sale of stock of a subsidiary.

B) Dividends paid to shareholders.

C) Purchase of treasury stock.

Explanation

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

(Module 20.1, LOS 20.a)