Exam 4 Chapters 12-14 Libby 7ed

Student: ____

1. Which of the following is the best description of investments in trading securities?
   A. Investments in bonds that management intends to hold to maturity.
   B. Investments in stocks or bonds that are held primarily for the purpose of selling them in the near future.
   C. Investments in more than fifty percent of the voting stock of another company.
   D. Investments that provides the investor significant influence over the investee, but not control over the investee.

2. Piano Company owns 55% of the voting common stock shares of Keys Corporation. Which of the following is true?
   A. The investment would be accounted for using the equity method.
   B. The investment would be accounted for by consolidation.
   C. The investment would be accounted for under the market value method.
   D. The investment would be accounted for under the amortized cost method.

3. Which of the following is the best description of investments in available-for-sale securities?
   A. Investments in bonds that management intends to hold to maturity.
   B. Investments in stocks or bonds that are held primarily for the purpose of selling them in the near future.
   C. Investments in more than fifty percent of the voting stock of another company.
   D. Investments in securities that are accounted for under the market value method other than trading securities and held-to-maturity investments.

4. Gilman Company purchased 100,000 of the 250,000 shares of common stock of Burke Corporation on January 1, 2010, at $40 per share as a long-term investment. The records of Burke Corporation showed the following on December 31, 2010:

2010 net income	$575,000
Dividends declared and paid during December, 2010	$30,000
Market price per share	$42

   At what amount should Gilman Company report the Burke investment on the December 31, 2010 balance sheet?
   A. $4,218,000
   B. $4,000,000
   C. $4,124,000
   D. $3,800,000

5. On January 1, 2010, Entertainment Company acquired 15% of the outstanding voting stock of Rocker Company as a long-term investment in available-for-sale securities. During 2010, Rocker Company reported net income of $1,500,000 and dividends declared and paid of $250,000. How much income will be reported during 2010 from the Rocker investment?
   A. $225,000
   B. $37,500
   C. $187,500
   D. $250,000

6. On January 1, 2010, Short Company purchased as an available-for-sale investment, 20,000 shares (15% of the outstanding voting shares) of Daniel Corporation's $1 par value common stock at a cost of $50 per share. During November 2010, Daniel declared and paid a cash dividend of $2 per share. At December 31, 2010, end of the accounting period, Daniel's shares were selling at $48. The 2010 financial statements for Short Company should report the following amounts:

	Long-Term Investment	Unrealized Holding Gains/Losses	Investment Revenue
A.	1,000,000	40,000	40,000
B.	960,000	Zero	Zero
C.	1,000,000	80,000	Zero
D.	960,000	40,000	40,000

A. Option A
B. Option B
C. Option C
D. Option D

7. On July 1, 2010, as a long-term investment in available-for-sale securities, Wildlife Supply Company purchased 6,000 shares of the preferred stock (nonvoting) of Nature Company for $30 per share (18,000 shares outstanding). The records of Nature Company reflect the following:

2010 net income	$60,000
Dividends declared and paid during December, 2010	$6,500
December 31, 2010 market price per share	$27

The amount reported on the balance sheet by Wildlife Company for its investment at December 31, 2010 would be which of the following?
A. $160,000
B. $162,000
C. $182,000
D. $200,000

8. When accounting for investments in trading securities, any decline in market value below cost of the investments is reported in which of the following ways?
A. On the income statement as a realized loss.
B. On the income statement as an unrealized holding loss.
C. On the balance sheet as a realized loss.
D. On the balance sheet as an unrealized holding loss in the stockholders' equity section.

9. When is the equity method used to account for long-term investments in stocks?
A. When the investment is between 20 - 50% of the voting stock, regardless of whether or not significant influence can be achieved.
B. When the investment is greater than 50% of the voting stock, regardless of whether or not significant influence can be achieved.
C. When the investment is greater than 50% of the voting stock and significant influence can be achieved.
D. When the investment is between 20 - 50% of the voting stock and significant influence can be achieved.

10. Paxton Corporation acquired all of the outstanding voting stock of Stanley Company. How should the assets and liabilities of the acquired company be reported on the consolidated financial statements immediately after the acquisition?
A. Nominal estimated values determined by the parent company.
B. Market values on the date of the acquisition.
C. The previously reported book values.
D. Market values on the date of the acquisition less accumulated depreciation.

11. Which of the following accounts is only created as the result of acquiring a controlling interest in another company?
   A. Patents
   B. Goodwill
   C. Acquisition expense
   D. Acquisition revenue

12. Which of the following transactions would not create a cash flow?
   A. A company purchased some of its own stock from a stockholder.
   B. Amortization of a patent.
   C. Payment of a cash dividend.
   D. Sale of equipment at book value.

13. Which of the following transactions would not be reported as a cash flow from investing activities?
   A. Selling a depreciable asset for cash at a loss.
   B. Purchasing a patent using cash.
   C. Purchasing land in exchange for stock.
   D. Purchasing shares of stock of another company using cash.

14. Which of the following transactions would be reported as a cash flow from financing activities?
   A. The cash payment of interest expense.
   B. Acquiring land by signing a note payable.
   C. Paying cash to stockholders for dividends.
   D. Purchasing shares of stock of another company using cash.

15. Which of the following statements regarding use of the direct and indirect methods of determining cash flows from operating activities is incorrect?
   A. The indirect method starts with net income.
   B. The direct method calculates cash collected from customers.
   C. The majority of U.S. companies use the indirect method.
   D. The FASB recommends use of the indirect method.

16. Which of the following would be deducted from net income when determining cash flows from operating activities under the indirect method?
   A. An increase in accounts payable.
   B. Depreciation expense.
   C. A decrease in prepaid insurance.
   D. A gain on the sale of a depreciable asset.

17. Darwin Company, a manufacturer, has provided the following information pertaining to its recent year of operation:

   • Net income, $200,000;
   • Accounts receivable increased $18,000;
   • Prepaid insurance increased $7,000;
   • Depreciation expense was $25,000;
   • Loss on sale of a building was $22,000;
   • Wages payable increased $14,000;
   • Unearned revenue decreased $21,000.

   How much was Darwin's net cash inflow from operating activities?
   A. $227,000
   B. $215,000
   C. $171,000
   D. $257,000

18. Which of the following statements about the statement of cash flows is correct?
    A. A company with a net loss on the income statement will always have a net cash outflow from operating activities.
    B. A purchase of equipment is classified as a cash inflow from investing activities.
    C. Cash dividends received on stock investments are classified as cash flows from operating activities.
    D. Cash dividends paid are classified as cash flows from operating activities.

19. Which of the following items about the statement of cash flows is correct?
    A. Non-cash expenses such as depreciation are deducted from net income with the indirect method in computing cash flows from operating activities.
    B. Cash equivalents are highly liquid investments with maturities at the date of purchase of less than three months.
    C. The acquisition of land by issuing bonds payable would not appear on the statement of cash flows.
    D. Cash paid for interest would be classified as a financing cash flow.

20. Which of the following would not be considered a cash equivalent?
    A. A 30-day certificate of deposit.
    B. A ten-year treasury note purchased over nine years ago, which matures in two months.
    C. A three-month Treasury bill.
    D. A ten-year Treasury note purchased two months before maturity.

21. Allen Company's 2010 income statement reported total revenues, $850,000 and total expenses (including $40,000 depreciation) of $720,000. The 2009 balance sheet reported the following: accounts receivable—beginning balance, $50,000 and ending balance, $40,000; accounts payable—beginning balance, $22,000 and ending balance, $28,000. Therefore, based only on this information, how much was the 2010 net cash inflow from operating activities?
    A. $126,000
    B. $166,000
    C. $174,000
    D. $186,000

22. Which of the following is not reported as a cash flow from investing activities?
    A. Sale of a depreciable asset for cash.
    B. Purchasing land in exchange for common stock.
    C. Selling a long-term investment at a loss for cash.
    D. Purchase of a patent in exchange for cash.

23. KAJ Incorporated purchased a machine costing $100,000 by paying $20,000 and signing an $80,000 note payable. How would this transaction be reported within the cash flow from investing activities section of the cash flow statement?
    A. An outflow of $100,000.
    B. An outflow of $80,000.
    C. An outflow of $20,000.
    D. It would have no effect.

24. Which of the following statements about the capital acquisitions ratio is correct?
    A. A high ratio indicates less need for outside financing of property, plant and equipment.
    B. The ratio is computed by dividing cash flow from operations by the average net property, plant and equipment.
    C. A low ratio may indicate a failure to update property, plant and equipment which can limit a company's ability to compete in the future.
    D. The ratio is comparable across industries.

25. During 2010, Eva's Enterprises cash paid for property, plant and equipment was $755 million and cash flow from operations was $5,968 million. The average property, plant and equipment from the comparative balance sheets were $6,094 million. Compute Eva's Enterprises capital acquisitions ratio for 2010.
A. 1.0
B. 5.3
C. 7.9
D. 6.0

26. Madison Company had sales of $154,000. Additional information from the balance sheet is below:

	Beginning Balance	Ending Balance
Accounts Receivable	$22,000	$28,000
Accounts Payable	21,000	25,000

How much cash was collected from customers?
A. $148,000
B. $150,000
C. $154,000
D. $160,000

27. The financial statements for World Company show the following:

Cost of goods sold, $725,000.

	Beginning Balance	Ending Balance
Merchandise Inventory	$45,000	$56,000
Accounts Receivable	53,000	50,000
Accounts Payable	37,000	42,000

How much cash was paid to suppliers?
A. $731,000
B. $736,000
C. $719,000
D. $714,000

28. Canadian Beer reported they sold equipment for $222 million cash and purchased $1,515 million of new equipment using cash. The equipment sold had a net book value of $150 million. Cash flow from investing activities would show
A. an inflow of $222 million and outflow of $1,515 million.
B. an inflow of $222 million and outflow of $150 million.
C. cash paid for equipment of $1,293 million.
D. a net outflow of $1,365 million.

29. There are several fundamental purposes decision makers consider when they use financial data. Which of the following statements is not one of those fundamental purposes?
A. Measurement of the current condition of the business.
B. Measurement of past performance of the business.
C. Measurement of the book value of the assets.
D. Prediction of future potential of the business.

30. Which of the following statements is correct?
A. A ratio calculation is most relevant in isolation.
B. One of the advantages of ratio analysis is that it allows companies of different sizes to be compared.
C. Finding benchmarks for comparison is a straight-forward task.
D. It is always preferable to compare a company's performance to industry-wide ratios rather than to use a competitor's ratios.

31. The base amount in preparing a common-size income statement is usually which of the following?
A. Income from operations
B. Gross profit
C. Net income
D. Net sales

32. Which of the following ratios is not considered to be a test of profitability?
A. Current ratio
B. Profit margin
C. Return on assets
D. Earnings per share

33. The records of Marshall Company include the following:

Average total assets	$3,500,000
Average total liabilities	1,220,000
Total revenue	4,580,000
Total expense (including income tax)	4,100,000
Interest expense (included in total expenses)	90,000
Income tax rate 40%	

The return on equity is (round to the nearest tenth of a percent)
A. 21.1%.
B. 10.2%.
C. 16.4%.
D. 17.1%.

34. Trenton Company has provided the following information:

• Net income, $240,000;
• Preferred shares issued, 6,000;
• Average common shares issued, 24,000;
• Common cash dividends declared and paid, $30,000;
• Market price per share, $36
• Average treasury shares of common stock, 4,000.

What were Trenton's earnings per share?
A. $8.00
B. $7.00
C. $10.50
D. $12.00

35. Trenton Company has provided the following information:

• Net income, $240,000;
• Preferred shares issued, 6,000;
• Average common shares issued, 24,000;
• Common cash dividends declared and paid, $30,000;
• Market price per share, $36
• Average treasury shares of common stock, 4,000.

What was Trenton's price earnings ratio?
A. 3.0
B. 5.1
C. 3.4
D. 4.5

36. Negative financial leverage occurs when the
   A. average net (after tax) interest rate on borrowed funds is less than the company's earnings rate on its assets.
   B. return on assets is more than return on equity.
   C. return on equity is more than return on assets.
   D. operating expenses exceed gross margin.

37. Agnes Company reported the following data:

Quick assets	$55,000
Current assets	150,000
Total liabilities	300,000
Average net receivables	12,600
Beginning inventory	38,000
Long-term liabilities	200,000
Net credit sales	126,000
Cost of goods sold	84,000
Ending inventory	46,000

   What was the current ratio?
   A. 0.5
   B. 1.5
   C. 2.5
   D. 0.75

38. Agnes Company reported the following data:

Quick assets	$55,000
Current assets	150,000
Total liabilities	300,000
Average net receivables	12,600
Beginning inventory	38,000
Long-term liabilities	200,000
Net credit sales	126,000
Cost of goods sold	84,000
Ending inventory	46,000

   What was the inventory turnover ratio?
   A. 2.2
   B. 1.8
   C. 2.0
   D. 3.0

39. The debt-to-equity ratio measures which of the following?
   A. Liquidity
   B. Solvency
   C. Profitability
   D. Market strength

40. Which ratio reflects the stock market's assessment of a company's future performance?
   A. Price/earnings ratio
   B. Dividend yield ratio
   C. Fixed asset turnover ratio
   D. Cash coverage ratio

Exam 4 Chapters 12-14 Libby 7ed Key

1. Which of the following is the best description of investments in trading securities?
   A. Investments in bonds that management intends to hold to maturity.
   B. Investments in stocks or bonds that are held primarily for the purpose of selling them in the near future.
   C. Investments in more than fifty percent of the voting stock of another company.
   D. Investments that provides the investor significant influence over the investee, but not control over the investee.

   The trading securities classification is used for those investments intended to be sold in the short-run.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 12-01 Analyze and report investments in debt securities held to maturity.
   Libby - Chapter 12 #31
   Topic Area: Types Of Investments And Accounting Methods

2. Piano Company owns 55% of the voting common stock shares of Keys Corporation. Which of the following is true?
   A. The investment would be accounted for using the equity method.
   B. The investment would be accounted for by consolidation.
   C. The investment would be accounted for under the market value method.
   D. The investment would be accounted for under the amortized cost method.

   An investment of more than 50% of the outstanding voting stock requires the parent company to use the consolidation method.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 12-01 Analyze and report investments in debt securities held to maturity.
   Libby - Chapter 12 #32
   Topic Area: Types Of Investments And Accounting Methods

3. Which of the following is the best description of investments in available-for-sale securities?
   A. Investments in bonds that management intends to hold to maturity.
   B. Investments in stocks or bonds that are held primarily for the purpose of selling them in the near future.
   C. Investments in more than fifty percent of the voting stock of another company.
   D. Investments in securities that are accounted for under the market value method other than trading securities and held-to-maturity investments.

   Available-for-sale securities are passive investments other than trading securities and held-to-maturity debt.

   AACSB: Reflective Thinking
   AICPA BB: Critical Thinking
   AICPA FN: Reporting
   Blooms: Understand
   Difficulty: Medium
   Learning Objective: 12-01 Analyze and report investments in debt securities held to maturity.
   Libby - Chapter 12 #33
   Topic Area: Types Of Investments And Accounting Methods

4. Gilman Company purchased 100,000 of the 250,000 shares of common stock of Burke Corporation on January 1, 2010, at $40 per share as a long-term investment. The records of Burke Corporation showed the following on December 31, 2010:

2010 net income	$575,000
Dividends declared and paid during December, 2010	$30,000
Market price per share	$42

At what amount should Gilman Company report the Burke investment on the December 31, 2010 balance sheet?

A. $4,218,000
B. $4,000,000
C. $4,124,000
D. $3,800,000

Investment in Burke ($4,218,000) = Initial cost ($4,000,000) + Proportionate share of Burke's net income ($575,000 × 100,000/250,000) - Proportionate share of Burke's dividends ($30,000 × 100,000/250,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Apply
Difficulty: Medium
Learning Objective: 12-03 Analyze and report investments involving significant influence using the equity method.
Libby - Chapter 12 #40
Topic Area: Investments For Significant Influence: Equity Method

5. On January 1, 2010, Entertainment Company acquired 15% of the outstanding voting stock of Rocker Company as a long-term investment in available-for-sale securities. During 2010, Rocker Company reported net income of $1,500,000 and dividends declared and paid of $250,000. How much income will be reported during 2010 from the Rocker investment?

A. $225,000
B. $37,500
C. $187,500
D. $250,000

2010 investment (dividend) income ($37,500) = Proportionate share of Rocker's dividends ($250,000 × .15)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Apply
Difficulty: Medium
Learning Objective: 12-02 Analyze and report passive investments in securities using the fair value method.
Libby - Chapter 12 #42
Topic Area: Passive Investments: The Fair Value Method

6. On January 1, 2010, Short Company purchased as an available-for-sale investment, 20,000 shares (15% of the outstanding voting shares) of Daniel Corporation's $1 par value common stock at a cost of $50 per share. During November 2010, Daniel declared and paid a cash dividend of $2 per share. At December 31, 2010, end of the accounting period, Daniel's shares were selling at $48. The 2010 financial statements for Short Company should report the following amounts:

	Long-Term Investment	Unrealized Holding Gains/Losses	Investment Revenue
A.	1,000,000	40,000	40,000
B.	960,000	Zero	Zero
C.	1,000,000	80,000	Zero
D.	960,000	40,000	40,000

A. Option A
B. Option B
C. Option C
D. Option D

Available-for-sale security unrealized gains and losses ($2 × 20,000) are reported on the balance within stockholders' equity; the investment account is reported on the balance sheet at fair value ($48 × 20,000); the investment revenue is the dividend revenue ($2 × 20,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 12-02 Analyze and report passive investments in securities using the fair value method.
Libby - Chapter 12 #46
Topic Area: Passive Investments: The Fair Value Method

7. On July 1, 2010, as a long-term investment in available-for-sale securities, Wildlife Supply Company purchased 6,000 shares of the preferred stock (nonvoting) of Nature Company for $30 per share (18,000 shares outstanding). The records of Nature Company reflect the following:

2010 net income	$60,000
Dividends declared and paid during December, 2010	$6,500
December 31, 2010 market price per share	$27

The amount reported on the balance sheet by Wildlife Company for its investment at December 31, 2010 would be which of the following?
A. $160,000
B. $162,000
C. $182,000
D. $200,000

Available-for-sale securities are reported on the balance sheet at fair value ($27 × 6,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 12-02 Analyze and report passive investments in securities using the fair value method.
Libby - Chapter 12 #49
Topic Area: Passive Investments: The Fair Value Method

8. When accounting for investments in trading securities, any decline in market value below cost of the investments is reported in which of the following ways?

A. On the income statement as a realized loss.
B. On the income statement as an unrealized holding loss.
C. On the balance sheet as a realized loss.
D. On the balance sheet as an unrealized holding loss in the stockholders' equity section.

Trading security unrealized gains and losses are reported within the income statement.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Understand
Difficulty: Medium
Learning Objective: 12-02 Analyze and report passive investments in securities using the fair value method.
Libby - Chapter 12 #51
Topic Area: Passive Investments: The Fair Value Method

9. When is the equity method used to account for long-term investments in stocks?

A. When the investment is between 20 - 50% of the voting stock, regardless of whether or not significant influence can be achieved.
B. When the investment is greater than 50% of the voting stock, regardless of whether or not significant influence can be achieved.
C. When the investment is greater than 50% of the voting stock and significant influence can be achieved.
D. When the investment is between 20 - 50% of the voting stock and significant influence can be achieved.

The investment must be between 20 to 50% of the voting stock and significant influence must be achieved.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 12-03 Analyze and report investments involving significant influence using the equity method.
Libby - Chapter 12 #58
Topic Area: Investments For Significant Influence: Equity Method

10. Paxton Corporation acquired all of the outstanding voting stock of Stanley Company. How should the assets and liabilities of the acquired company be reported on the consolidated financial statements immediately after the acquisition?

A. Nominal estimated values determined by the parent company.
B. Market values on the date of the acquisition.
C. The previously reported book values.
D. Market values on the date of the acquisition less accumulated depreciation.

The acquired net assets are recorded based on their market values on the acquisition date.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 12-04 Analyze and report investments in controlling interests.
Libby - Chapter 12 #77
Topic Area: Controlling Interests: Mergers And Acquisitions

11. Which of the following accounts is only created as the result of acquiring a controlling interest in another company?

A. Patents
B. Goodwill
C. Acquisition expense
D. Acquisition revenue

Goodwill is only created as the result of a controlling interest in another company.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 12-04 Analyze and report investments in controlling interests.
Libby - Chapter 12 #90
Topic Area: Controlling Interests: Mergers And Acquisitions

12. Which of the following transactions would not create a cash flow?

A. A company purchased some of its own stock from a stockholder.
B. Amortization of a patent.
C. Payment of a cash dividend.
D. Sale of equipment at book value.

Patent amortization is a noncash expense.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #31
Topic Area: Classifications On The Statement Of Cash Flows

13. Which of the following transactions would not be reported as a cash flow from investing activities?

A. Selling a depreciable asset for cash at a loss.
B. Purchasing a patent using cash.
C. Purchasing land in exchange for stock.
D. Purchasing shares of stock of another company using cash.

Purchasing the land using stock doesn't involve a cash flow and is therefore not considered to be an investing cash flow.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #33
Topic Area: Classifications On The Statement Of Cash Flows

14. Which of the following transactions would be reported as a cash flow from financing activities?
A. The cash payment of interest expense.
B. Acquiring land by signing a note payable.
C. Paying cash to stockholders for dividends.
D. Purchasing shares of stock of another company using cash.

Payments of cash dividends are considered to be financing cash flows.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #34
Topic Area: Classifications On The Statement Of Cash Flows

15. Which of the following statements regarding use of the direct and indirect methods of determining cash flows from operating activities is incorrect?
A. The indirect method starts with net income.
B. The direct method calculates cash collected from customers.
C. The majority of U.S. companies use the indirect method.
D. The FASB recommends use of the indirect method.

The FASB recommends use of the direct method.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #35
Topic Area: Classifications On The Statement Of Cash Flows

16. Which of the following would be deducted from net income when determining cash flows from operating activities under the indirect method?
A. An increase in accounts payable.
B. Depreciation expense.
C. A decrease in prepaid insurance.
D. A gain on the sale of a depreciable asset.

A gain on the sale of a depreciable asset would be deducted from net income because the transaction is an investing cash flow.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Understand
Difficulty: Medium
Learning Objective: 13-02 Report and interpret cash flows from operating activities using the indirect method.
Libby - Chapter 13 #36
Topic Area: Reporting And Interpreting Cash Flows From Operating Activities

17. Darwin Company, a manufacturer, has provided the following information pertaining to its recent year of operation:

• Net income, $200,000;
• Accounts receivable increased $18,000;
• Prepaid insurance increased $7,000;
• Depreciation expense was $25,000;
• Loss on sale of a building was $22,000;
• Wages payable increased $14,000;
• Unearned revenue decreased $21,000.

How much was Darwin's net cash inflow from operating activities?
A. $227,000
B. $215,000
C. $171,000
D. $257,000

Net cash inflow from operating activities ($215,000) = Net income ($200,000) - Accounts receivable increase ($18,000) - Prepaid insurance increase ($7,000) + Depreciation expense ($25,000) + Loss on sale of building ($22,000) + Wages payable increase ($14,000) - Unearned revenue decrease ($21,000)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 13-02 Report and interpret cash flows from operating activities using the indirect method.
Libby - Chapter 13 #40
Topic Area: Reporting And Interpreting Cash Flows From Operating Activities

18. Which of the following statements about the statement of cash flows is correct?
A. A company with a net loss on the income statement will always have a net cash outflow from operating activities.
B. A purchase of equipment is classified as a cash inflow from investing activities.
C. Cash dividends received on stock investments are classified as cash flows from operating activities.
D. Cash dividends paid are classified as cash flows from operating activities.

Receipt of cash dividends are reported as operating cash flows.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #48
Topic Area: Classifications On The Statement Of Cash Flows

19. Which of the following items about the statement of cash flows is correct?

A. Non-cash expenses such as depreciation are deducted from net income with the indirect method in computing cash flows from operating activities.

B. Cash equivalents are highly liquid investments with maturities at the date of purchase of less than three months.

C. The acquisition of land by issuing bonds payable would not appear on the statement of cash flows.

D. Cash paid for interest would be classified as a financing cash flow.

Cash equivalents are highly liquid and have maturities at the date of purchase of three months or less.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #49
Topic Area: Classifications On The Statement Of Cash Flows

20. Which of the following would not be considered a cash equivalent?

A. A 30-day certificate of deposit.

B. A ten-year treasury note purchased over nine years ago, which matures in two months.

C. A three-month Treasury bill.

D. A ten-year Treasury note purchased two months before maturity.

The ten-year note purchased over nine years ago will not become a cash equivalent.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #47
Topic Area: Classifications On The Statement Of Cash Flows

21. Allen Company's 2010 income statement reported total revenues, $850,000 and total expenses (including $40,000 depreciation) of $720,000. The 2009 balance sheet reported the following: accounts receivable—beginning balance, $50,000 and ending balance, $40,000; accounts payable—beginning balance, $22,000 and ending balance, $28,000. Therefore, based only on this information, how much was the 2010 net cash inflow from operating activities?

A. $126,000

B. $166,000

C. $174,000

D. $186,000

Net cash inflow from operating activities ($136,000) = Net income ($850,000 - $720,000) + Depreciation expense ($40,000) + Accounts receivable decrease ($10,000) + Accounts payable increase ($6,000)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 13-02 Report and interpret cash flows from operating activities using the indirect method.
Libby - Chapter 13 #50
Topic Area: Reporting And Interpreting Cash Flows From Operating Activities

22. Which of the following is not reported as a cash flow from investing activities?
A. Sale of a depreciable asset for cash.
B. Purchasing land in exchange for common stock.
C. Selling a long-term investment at a loss for cash.
D. Purchase of a patent in exchange for cash.

Purchasing land using common stock doesn't involve a cash flow and is therefore not reported within the investing cash flows section of the cash flow statement.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Remember
Difficulty: Easy
Learning Objective: 13-04 Report and interpret cash flows from investing activities.
Libby - Chapter 13 #55
Topic Area: Reporting And Interpreting Cash Flows From Investing Activities

23. KAJ Incorporated purchased a machine costing $100,000 by paying $20,000 and signing an $80,000 note payable. How would this transaction be reported within the cash flow from investing activities section of the cash flow statement?
A. An outflow of $100,000.
B. An outflow of $80,000.
C. An outflow of $20,000.
D. It would have no effect.

The investing cash flows section of the cash flow statement would include the $20,000 cash payment.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Understand
Difficulty: Easy
Learning Objective: 13-04 Report and interpret cash flows from investing activities.
Libby - Chapter 13 #57
Topic Area: Reporting And Interpreting Cash Flows From Investing Activities

24. Which of the following statements about the capital acquisitions ratio is correct?
A. A high ratio indicates less need for outside financing of property, plant and equipment.
B. The ratio is computed by dividing cash flow from operations by the average net property, plant and equipment.
C. A low ratio may indicate a failure to update property, plant and equipment which can limit a company's ability to compete in the future.
D. The ratio is comparable across industries.

The capital acquisitions ratio is calculated by dividing cash flow from operating activities by cash paid for property, plant, and equipment. A high ratio implies the ability to finance fixed asset acquisitions from operations cash flows.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Understand
Difficulty: Medium
Learning Objective: 13-05 Analyze and interpret the capital acquisitions ratio.
Libby - Chapter 13 #61
Topic Area: Key Ratio Analysis

25. During 2010, Eva's Enterprises cash paid for property, plant and equipment was $755 million and cash flow from operations was $5,968 million. The average property, plant and equipment from the comparative balance sheets were $6,094 million. Compute Eva's Enterprises capital acquisitions ratio for 2010.

A. 1.0
B. 5.3
C. 7.9
D. 6.0

The capital acquisitions ratio (7.9) is calculated by dividing cash flow from operating activities ($5,968) by cash paid for property, plant, and equipment ($755).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 13-05 Analyze and interpret the capital acquisitions ratio.
Libby - Chapter 13 #63
Topic Area: Key Ratio Analysis

26. Madison Company had sales of $154,000. Additional information from the balance sheet is below:

	Beginning Balance	Ending Balance
Accounts Receivable	$22,000	$28,000
Accounts Payable	21,000	25,000

How much cash was collected from customers?

A. $148,000
B. $150,000
C. $154,000
D. $160,000

Cash collected from customers ($148,000) = Sales ($154,000) - Accounts receivable increase ($6,000)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #68
Topic Area: Reporting And Interpreting Cash Flows From Operating Activities

27. The financial statements for World Company show the following:

Cost of goods sold, $725,000.

	Beginning Balance	Ending Balance
Merchandise Inventory	$45,000	$56,000
Accounts Receivable	53,000	50,000
Accounts Payable	37,000	42,000

How much cash was paid to suppliers?
A. $731,000
B. $736,000
C. $719,000
D. $714,000

Cash paid to suppliers ($731,000) = Cost of goods sold ($725,000) + Inventory increase ($11,000) - Accounts payable increase ($5,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 13-01 Classify cash flow statement items as part of net cash flows from operating; investing; and financing activities.
Libby - Chapter 13 #67
Topic Area: Reporting And Interpreting Cash Flows From Operating Activities

28. Canadian Beer reported they sold equipment for $222 million cash and purchased $1,515 million of new equipment using cash. The equipment sold had a net book value of $150 million. Cash flow from investing activities would show
A. an inflow of $222 million and outflow of $1,515 million.
B. an inflow of $222 million and outflow of $150 million.
C. cash paid for equipment of $1,293 million.
D. a net outflow of $1,365 million.

The cash outflow ($1,515) and cash inflow ($222) are reported separately.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Reporting, Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 13-04 Report and interpret cash flows from investing activities.
Libby - Chapter 13 #71
Topic Area: Reporting And Interpreting Cash Flows From Investing Activities

29. There are several fundamental purposes decision makers consider when they use financial data. Which of the following statements is not one of those fundamental purposes?
A. Measurement of the current condition of the business.
B. Measurement of past performance of the business.
C. Measurement of the book value of the assets.
D. Prediction of future potential of the business.

The book value is reported and doesn't need to be measured.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Blooms: Remember
Difficulty: Easy
Learning Objective: 14-01 Explain how a companys business strategy affects financial analysis.
Libby - Chapter 14 #31
Topic Area: Understanding A Companys Strategy

30. Which of the following statements is correct?

A. A ratio calculation is most relevant in isolation.

B. One of the advantages of ratio analysis is that it allows companies of different sizes to be compared.

C. Finding benchmarks for comparison is a straight-forward task.

D. It is always preferable to compare a company's performance to industry-wide ratios rather than to use a competitor's ratios.

A significant outcome of ratio analysis is the ability to compare different size firms.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Understand
Difficulty: Medium
Learning Objective: 14-02 Discuss how analysts use financial statements.
Libby - Chapter 14 #39
Topic Area: Financial Statement Analysis

31. The base amount in preparing a common-size income statement is usually which of the following?

A. Income from operations

B. Gross profit

C. Net income

D. Net sales

Net sales are the base figure.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Remember
Difficulty: Easy
Learning Objective: 14-03 Compute and interpret component percentages.
Libby - Chapter 14 #40
Topic Area: Ratio and Percentage Analysis

32. Which of the following ratios is not considered to be a test of profitability?

A. Current ratio

B. Profit margin

C. Return on assets

D. Earnings per share

The current ratio measures liquidity.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Understand
Difficulty: Easy
Learning Objective: 14-04 Compute and interpret profitability ratios.
Learning Objective: 14-05 Compute and interpret liquidity ratios.
Libby - Chapter 14 #44
Topic Area: Ratio and Percentage Analysis

33. The records of Marshall Company include the following:

Average total assets	$3,500,000
Average total liabilities	1,220,000
Total revenue	4,580,000
Total expense (including income tax)	4,100,000
Interest expense (included in total expenses)	90,000
Income tax rate 40%	

The return on equity is (round to the nearest tenth of a percent)

A. 21.1%.
B. 10.2%.
C. 16.4%.
D. 17.1%.

The return on equity ratio (21.1%) = Net income ($4,580,000 - $4,100,000) ÷ Average stockholders' equity ($3,500,000 - $1,220,000)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 14-04 Compute and interpret profitability ratios.
Libby - Chapter 14 #47
Topic Area: Ratio and Percentage Analysis

34. Trenton Company has provided the following information:

• Net income, $240,000;
• Preferred shares issued, 6,000;
• Average common shares issued, 24,000;
• Common cash dividends declared and paid, $30,000;
• Market price per share, $36
• Average treasury shares of common stock, 4,000.

What were Trenton's earnings per share?

A. $8.00
B. $7.00
C. $10.50
D. $12.00

Earnings per share ($12) = Net income ($240,000) ÷ Average number of common shares outstanding (24,000 - 4,000).

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 14-04 Compute and interpret profitability ratios.
Libby - Chapter 14 #51
Topic Area: Ratio and Percentage Analysis

35. Trenton Company has provided the following information:

• Net income, $240,000;
• Preferred shares issued, 6,000;
• Average common shares issued, 24,000;
• Common cash dividends declared and paid, $30,000;
• Market price per share, $36
• Average treasury shares of common stock, 4,000.

What was Trenton's price earnings ratio?

A. 3.0
B. 5.1
C. 3.4
D. 4.5

Earnings per share ($12) = Net income ($240,000) ÷ Average number of common shares outstanding (24,000 - 4,000).
Price earnings ratio (3) = Market price per share ($36) ÷ Earnings per share ($12)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Hard
Learning Objective: 14-07 Compute and interpret market test ratios.
Libby - Chapter 14 #52
Topic Area: Ratio and Percentage Analysis

36. Negative financial leverage occurs when the

A. average net (after tax) interest rate on borrowed funds is less than the company's earnings rate on its assets.
B. return on assets is more than return on equity.
C. return on equity is more than return on assets.
D. operating expenses exceed gross margin.

Financial leverage percentage equals return on equity minus return on assets.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Remember
Difficulty: Medium
Learning Objective: 14-04 Compute and interpret profitability ratios.
Libby - Chapter 14 #55
Topic Area: Financial Statement Analysis

37. Agnes Company reported the following data:

Quick assets	$55,000
Current assets	150,000
Total liabilities	300,000
Average net receivables	12,600
Beginning inventory	38,000
Long-term liabilities	200,000
Net credit sales	126,000
Cost of goods sold	84,000
Ending inventory	46,000

What was the current ratio?

A. 0.5
B. 1.5
C. 2.5
D. 0.75

Current ratio (1.5) = Current assets ($150,000) ÷ Current liabilities ($300,000 - $200,000)

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 14-05 Compute and interpret liquidity ratios.
Libby - Chapter 14 #60
Topic Area: Financial Statement Analysis

38. Agnes Company reported the following data:

Quick assets	$55,000
Current assets	150,000
Total liabilities	300,000
Average net receivables	12,600
Beginning inventory	38,000
Long-term liabilities	200,000
Net credit sales	126,000
Cost of goods sold	84,000
Ending inventory	46,000

What was the inventory turnover ratio?

A. 2.2
B. 1.8
C. 2.0
D. 3.0

Inventory turnover ratio (2.0) = Cost of goods sold ($84,000) ÷ Average inventory ($38,000 + $46,000) ÷ 2

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Apply
Difficulty: Medium
Learning Objective: 14-05 Compute and interpret liquidity ratios.
Libby - Chapter 14 #61
Topic Area: Financial Statement Analysis

39. The debt-to-equity ratio measures which of the following?

A. Liquidity
B. Solvency
C. Profitability
D. Market strength

Debt-to-equity is a measure of solvency.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Understand
Difficulty: Easy
Learning Objective: 14-06 Compute and interpret solvency ratios.
Libby - Chapter 14 #74
Topic Area: Ratio and Percentage Analysis

40. Which ratio reflects the stock market's assessment of a company's future performance?

A. Price/earnings ratio
B. Dividend yield ratio
C. Fixed asset turnover ratio
D. Cash coverage ratio

The price/earnings ratio is a measure of investor confidence with respect to future earnings.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Blooms: Understand
Difficulty: Medium
Learning Objective: 14-04 Compute and interpret profitability ratios.
Learning Objective: 14-07 Compute and interpret market test ratios.
Libby - Chapter 14 #77
Topic Area: Ratio and Percentage Analysis

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