LO.a: Compare cash flows from operating, investing, and financing activities and classify cash flow items as relating to one of those three categories given a description of the items.

1. Which of the following activities will *most likely* increase the cash from investing activities for a company which manufactures and sells computers?
   A. Proceeds from issuance of corporate bonds.
   B. Proceeds from sale of manufacturing equipment.
   C. Proceeds from sale of computers.

2. A company recorded the following events in 2012:

Purchase of securities for trading purposes	$250,000
Proceeds from the sale of trading securities	$300,000
Proceeds from issuance of bonds	$500,000
Purchase of 30% of the shares of an affiliated company	$375,000

   On the 2012 statement of cash flows, the company's net cash flow from investing activities (in $'000s) is *closest* to:
   A. -375.
   B. -325.
   C. 125.

3. In 2012, Nerosoft Co. recorded unearned revenue related to their latest operating system license, which the company will recognize as revenue in 2013. Ignoring income taxes, this recognition of the operating system revenue will *most likely* have which of the following effects on cash from operations in 2012?
   A. No effect.
   B. A decrease.
   C. An increase.

4. A company's operating cash flow will *most likely* increase with an increase in:
   A. days sales payable.
   B. gains on the sale of long-term assets.
   C. use of operating leases versus financing leases.

5. A company entered into a financing arrangement with a bank, which allows the company to settle the amount owed to its suppliers through the bank. The company repays that amount to the bank in the following period. The motivation for the company's behavior is *most likely* to:
   A. improve its current ratio.
   B. improve its relations with its suppliers.
   C. manage the timing of operating cash flows.

6. Selected data of a company's operations is presented below:

Net Income	$150,000

Increase in Accounts receivable	20,000
Increase in Accounts payable	12,000
Depreciation and amortization	5,000

The cash flow from operations is *closest* to:
A. $147,000.
B. $153,000.
C. $155,000.

7. Which of the following *least likely* represents a financing activity?
   A. Repayment of a long-term debt.
   B. Issuance of new equity.
   C. Payment to reduce a company's accounts payable balance.

8. MNC Corporation recorded the following events in 2011:

Purchase of securities for trading purposes	$ 480,000
Proceeds from the sale of trading securities	600,000
Proceeds from issuance of bonds	1,000,000
Purchase of 30% of the shares of an affiliated company	550,000

On the 2012 statement of cash flows, MNC's net cash flow from investing activities is *closest* to:
A. 570,000.
B. 550,000.
C. 430,000.

9. Cash receipts and payments related to dealing or trading securities are classified as:
   A. operating cash flow.
   B. investing cash flow.
   C. financing cash flow.

10. JFK Enterprises recorded the following for the year 2012:

Purchase of equipment	$70,000
Gain from sale of van	$8,000
Receipts from sale of van	$18,000
Dividends paid on ordinary share capital	$10,000
Interest and preference dividend paid	$12,000
Salaries paid	$40,000

Which of the following is *most likely* to be the net cash flow from investing activities?
A. $44,000 outflow.
B. $52,000 outflow.
C. $66,000 outflow.

11. Lincoln Ltd issued a $20,000 200-day note at 10%, and used the cash to pay for salaries. It also issued long-term debt worth $90,000 at 10% annually and used the cash to purchase equipment for the new office. The combined effect of these transactions is *least likely* to be:
    A. a decrease in operating cash flow by $20,000.
    B. an increase in financing activity by $110,000.
    C. an increase in investing activity by $20,000.

LO.b: Describe how non-cash investing and financing activities are reported.

12. Which of the following is *least likely* a non-cash transaction?
    A. Issuing stock dividends.
    B. Acquiring land using long-term debt.
    C. Purchasing machinery with notes payable.

13. Significant non-cash transactions are *most likely* disclosed in:
    A. The cash flow statement.
    B. A separate note or supplementary schedule to the cash flow statement.
    C. Neither of the above.

LO.c: Contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP).

14. Which of the following statements is correct?
    A. Under IFRS, interest paid is considered an investing cash flow.
    B. Under U.S. GAAP, dividends received is considered a financing cash flow.
    C. Under U.S. GAAP, interest paid is considered an operating cash flow.

15. In a cash flow statement prepared according to U.S. GAAP, interest paid is *most likely* included in which activity?
    A. Operating.
    B. Financing.
    C. Either operating or financing.

16. Aero Corp. prepares its financial statements using IFRS. It reports its interest payment on long-term debt as a financing activity. If the company reports under U.S. GAAP, the *most likely* effect on the cash flow statement would be a(n):
    A. decrease in cash flow from investing activities.
    B. increase in cash flow from operating activities.
    C. increase in cash flow from financing activities.

17. Dividends received are *most likely* classified as which type of cash flow under U.S. GAAP?
    A. Investing.
    B. Financing.
    C. Operating.

18. Which of the following statements is *least accurate* regarding cash flow statements prepared under IFRS and U.S. GAAP?
    A. Under U.S. GAAP, dividends paid are considered as a financing activity.
    B. Under IFRS, interest paid can be reported either as an operating or a financing cash flow.
    C. Under U.S. GAAP, bank overdrafts are considered as a part of cash and cash equivalents.

19. Dividends paid are *most likely* classified as which type of cash flow under both IFRS and U.S.GAAP?
    A. Investing.
    B. Financing.
    C. Operating.

20. The excerpt from a company's cash flow statement is presented below:

Operating activities:	
Cash received from customers	£50,000
Investing activities:	
Interest and dividends received	£10,000
Financing activities:	
Net repayment of revolving credit loan	£25,000

    Which of the following standards and formats did the company *most likely* use in the preparation of its financial statements?
    A. IFRS, direct format.
    B. IFRS, indirect format.
    C. Either IFRS or U.S. GAAP, direct format.

LO.d: Distinguish between the direct and indirect methods of presenting cash from operating activities and describe arguments in favor of each method.

21. An analyst chooses the direct method rather than the indirect method for analyzing a firm's operating cash flows. The *most likely* reason for his selection is to:
    A. understand the impact of non-cash items.
    B. identify operating cash flows by source and by use.
    C. understand the relationship between net income and operating cash flows.

22. Compared with the indirect method for reporting cash flow from operating activities, the *least likely* benefit of the direct method is that it provides:
    A. supplementary data under U.S. GAAP.
    B. details on the specific sources of operating receipts and payments.
    C. insight on differences between net income and operating cash flows.

23. Which of the following cash flows is *most likely* to have two formats, direct and indirect?
    A. Financing.
    B. Investing.
    C. Operating.

24. Which of the following statements is *most likely* correct about the indirect method of operating cash flow?
    A. An increase in current asset is subtracted from net income.
    B. A decrease in current asset is subtracted from net income.
    C. An increase in current liability is subtracted from net income.

25. Which of the following statements is *least likely* accurate about the indirect method of operating cash flow?
    A. Non-cash items are added to net income.
    B. Non-operating losses are added to net income.
    C. Decrease in deferred income tax liability is added to net income.

LO.e: Describe how the cash flow statement is linked to the income statement and the balance sheet.

26. A manufacturing company has an accounts receivable balance of $10 million on 1 January 2014. During 2014 the reported revenue was $150 million and cash collected from customers was $155 million. The accounts receivable balance on 31 December 2014 was most likely:
    A. $5 million.
    B. $10 million.
    C. $15 million.

27. In 2012, PIA recorded unearned revenue related to advance booking of its tickets that it will recognize as revenue during 2013. Ignoring income taxes, recognizing advance sale revenue will *most likely* have which of the following effects on cash from operations in 2013?
    A. A decrease.
    B. No effect.
    C. An increase.

28. In 2012, PIA recorded unearned revenue related to advance booking of its tickets, which it will recognize as revenue during 2013. This recognition of the advance sale revenue will *most likely* have which of the following effects on cash from operations in 2013?
    A. A decrease.
    B. No effect.
    C. An increase.

LO.f: Describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data.

29. The following information is available about a company:

Selected Income Statement Data for the year ended December 31st (US$ thousands)

	2013	2012
Sales revenue	$150,000	$ 90,000
Cost of goods sold	95,000	69,500
Depreciation expense	5,000	3,000
Net income	$ 18,150	$ 6,550
Selected Balance Sheet Data As of December 31st (US$ thousands)		
	2013	2012
Current Assets		
Cash & investments	$ 50,250	$ 35,000
Accounts receivable	$20,000	$15,200
Inventories	$20,000	$12,800
Total current assets	$90,250	$63,000
Current Liabilities		
Accounts payable	$ 25,000	$ 25,000
Other current liabilities	$7,000	$9,000
Total current liabilities	$ 32,000	$ 34,000

The cash collected from customers in 2013 is *closest* to:
A. $145,200.
B. $151,500.
C. $153,200.

30. The following information (in millions) is available about a company:

Cost of goods sold	$150
Increase in total assets	200
Increase in total liabilities	120
Change in inventory	(25)
Change in accounts payable	(30)

The amount of cash (in millions) that the company paid to its suppliers is *closest* to:
A. $145.
B. $155.
C. $205.

31. The following annual financial data is available for a company:

	£ millions
Beginning interest payable	85.3
Cash paid for interest	111.0
Ending interest payable	95.3

Interest expense for the year is *closest* to:

A. 101.0.
B. 111.0.
C. 121.0.

32. A security analyst is *least likely* to interpret the accounting process of a company as a tool for:
A. aiding in the assessment of management's judgment in accruals and valuations.
B. making adjustments to reflect items not reported in the financial statements.
C. preventing earnings manipulation by management.

33. The following information is available for Nishant Mills Ltd:

Net income	$45,000
Depreciation	$18,000
Amortization	$10,000

Inventories increased by $1,500, accounts receivables decreased by $1,800, and accounts payables increased by $1,000. The net cash flow from operating activities under the indirect method is *closest* to:
A. $49,300.
B. $64,300.
C. $74,300.

34. The following information is available for Nissan Newspapers Ltd.

Cash balance as of June 30, 2012	$58,000
Cash balance as of July 1, 2011	$65,000
Cash flows:	
Operating activities	($45,000)
Financing activities	$90,000

The cash flow from investing activities is *closest* to:
A. ($52,000).
B. $13,000.
C. $52,000.

35. Amanda Mills Ltd. reported revenues of $10 million, expenses of $7.5 million, and a profit of $2.5 million. Accounts receivable increased by $4 million. The cash received from its customers is *closest* to:
A. $6 million.
B. $10 million.
C. $14 million.

36. An analyst collects the following information for Baking Butter Corporation:

Net revenue	$200,000

Gross profit	$50,000
Increase in inventory	$8,000
Increase in accounts payable	$12,000

The cash paid to its suppliers is *closest* to:
A. $146,000.
B. $154,000.
C. $170,000.

37. MG Laptops Ltd reported a cost of goods sold worth $120,000. Inventory purchases made during the year amounted to $150,000. If the beginning inventory is $40,000, what is the ending inventory?
A. 10,000.
B. 30,000.
C. 70,000.

38. At the beginning of the year, Donald owed his employees $16,000. The total salary expense incurred during the year amounted to $40,000. The cash flow statement showed a salary expense of $49,000. What liability did Donald record at the end of the year?
A. $7,000.
B. $9,000.
C. $25,000.

39. The other operating expenses reported by King Fishers Ltd. were $20 million. These comprised electricity expenses and insurance expense. The prepaid insurance expense decreased by $6 million. The accrued electricity expense increased by $8 million. The cash paid for other operating expenses is *closest* to:
A. $6 million.
B. $18 million.
C. $22 million.

40. The balance sheet extract for Jackal Labs Ltd. shows the machinery and accumulated depreciation balances for the years 2011 and 2012.

	2011	**2012**
Machinery	$80 million	$91 million
Accumulated depreciation	$25 million	$31 million

Further information provided is as follows:

Gain on sale of machinery	$1.5 million
Depreciation expense for 2012	$7 million
Capital expenditure on machinery	$14 million

How much did the company receive in cash from the sale of machinery?
A. $2 million.
B. $2.5 million.

C. $3.5 million.

41. Retiring long-term debt is a:
    A. cash outflow related to financing activities.
    B. cash inflow related to financing activities.
    C. neither of the above.

42. The retained earnings over the year increased by $4 million. The net income was $5 million. The dividend paid was *most likely*:
    A. -$1 million.
    B. 0.
    C. $1 million.

43. The following information is available for Frampton Corporation Ltd.

Cash received from customers	$12,000
Cash paid to employees	$2,000
Cash paid for income tax	$1,500
Cash paid for purchase of equipment	$20,000
Cash paid for dividends	$1,800
Cash paid to retire long term debt	$15,000

The net cash from financing activities is *closest* to:
A. $16,500.
B. $16,800.
C. $20,000.

44. The following information is available for HTC Corporation.

Income Statement Extract	**2012**	**2011**
Operating income	$14 million	$12 million
Depreciation	$5 million	$3 million
Net income	$9 million	$7 million

Balance Sheet Extract	**2012**	**2011**
Current Assets	$8 million	$6 million
Current Liabilities	$10 million	$12 million

The total adjustment in order to compute operating cash flow is *closest* to:
A. ($2 million).
B. $1 million.
C. $5 million.

LO.g: Convert cash flows from the indirect to direct method.

45. Which of the following is *least likely* a step to convert cash flows from the indirect method to the direct method?

A. Aggregate all revenues and expenses.
B. Add noncash items to aggregated revenue and expenses.
C. Convert accrual amounts to cash flow amounts by adjusting for working capital changes.

46. Which of the following is least likely a calculation performed for converting cash flows from indirect method to the direct method?
    A. Add increase in accounts receivable to non-cash adjusted revenue.
    B. Add increase in inventory to cost of goods sold.
    C. Subtract increase in salary and wage payable from salary and wage expense.

LO.h: Analyze and interpret both reported and common-size cash flow statements.

47. In a common size analysis of the statement of cash flows, the items of cash flow may be presented as a percentage of:
    A. total cash flows.
    B. net revenue.
    C. either total cash flow or net revenue.

48. Cash flow is *most likely* to be negative:
    A. for a mature company.
    B. for a growth stage company.
    C. for a declining profits company.

49. The first step in cash flow statement analysis is:
    A. Evaluating the uses and sources of cash.
    B. Evaluating the drivers of operating cash flow.
    C. Evaluating if the elements are classified correctly.

50. Which of the following is least likely an approach for developing common-size cash flow statement?
    A. Total cash inflows/total cash outflows method.
    B. The percentage of net revenues method.
    C. Free cash flow to the firm method.

LO.i: Calculate and interpret free cash flow to the firm, free cash flow to equity, and performance and coverage cash flow ratios.

51. An analyst is *most likely* to conclude that there are problems with the quality of a company's earnings if the cash flow earnings index (operating cash flow divided by net income) were consistently:
    A. equal to 1.0.
    B. less than 1.0.
    C. greater than 1.0.

52. Which of the following statements is *least accurate* regarding cash flow ratios?
    A. Interest coverage ratio is calculated as EBIT over interest payments.

B. Debt payment ratio measures the firm's ability to pay debts with financing cash flows.
C. Reinvestment ratio measures the firm's ability to acquire assets with operating cash flows.

53. An analyst has gathered the following information about a company:

	CAD millions
Cash flow from operating activities	112.2
Cash flow from investing activities	(15.8)
Cash flow from financing activities	26.5
Net change in cash for the year	122.9
Interest paid (included in CFO)	13.3
Taxes paid (tax rate of 30%)	10.0
Total debt, end of year	462.5

The cash flow debt coverage ratio for the year is *closest* to:
A. 19.2%.
B. 24.3%.
C. 26.6%.

54. What is the most likely impact of an increase in net borrowing on the free cash flow to equity (FCFE) for a firm?
A. No impact.
B. Decrease in FCFE.
C. Increase in FCFE.

55. The following data is available for a firm:

	$ millions
Net income	45.0
Non-cash charges	12.3
Interest expense	2.6
Capital expenditures	15.0
Working capital expenditures	8.1

If the firm's tax rate is 30%, the free cash flow to the firm (FCFF) is *closest* to:
A. $36.02 million.
B. $51.02 million.
C. $51.80 million.

56. The following information is available for a company:

Cash Flow Item	**CAD**
Net income	500,000
Non-cash charges	30,000
Interest expense	50,000
Capital expenditure	180,000
Net borrowing	150,000

Tax rate	35%

The free cash flow to the firm (in CAD) is *closest* to:
A. 382,500.
B. 400,000.
C. 532,500.

57. The following data is available for NRL:

	$ millions
Net Income	180.0
Non-cash charges	30.4
Interest expense	56.0
Capital expenditures	68.6
Working capital expenditures	26.0

If NRL's tax rate is 30%, the free cash flow to the firm (FCFF) is *closest* to:
A. 171.8.
B. 155.0.
C. 132.6.

58. The net income of a company is reported to be $45,000. The only non-cash charge is depreciation which equals $4000. The interest expense is $5,000. Fixed capital expenditure and working capital expenditure are $20,000 and $9,000 respectively. What is the free cash flow to the firm? Assume the tax rate is 40%.
A. $49,000.
B. $23,000.
C. $25,000.

59. The following information is available for Pinto Paints Ltd.

Net income	$30,000
Depreciation	$16,000
CAPEX	$9,000
WC expenditure	$7,000
Net debt repayment	$10,000
Cash flow from operations	$39,000

The free cash flow to equity of the company is *closest* to:
A. 10,000.
B. 20,000.
C. 30,000.

60. Which of the following ratios is *most likely* used to measure financial risk?
A. Debt coverage ratio.
B. Interest coverage ratio.

C. Reinvestment coverage ratio.

61. Free cash flow to firm can most likely be defined as:
    A. CFO + Interest (1 – Tax Rate) – Fixed Capital Investment.
    B. CFO + Interest (1 – Tax Rate) – Fixed Capital Investment – Working Capital Investment.
    C. CFO + Interest(1 – Tax Rate) + Fixed Capital Investment + Working Capital Investment.

Solutions

1. B is correct. The sale of equipment would increase cash from investing activities. Issuance of corporate bonds is a financing activity. Since the company manufactures and sells computers, option C represents an operating activity.

2. A is correct. Only the cash flows for the purchase of the shares in an affiliated company are cash from investing activities. Therefore, the net amount is -$375,000. Cash flows from trading securities are operating activities.

3. C is correct. The company received the cash in 2012 when it recorded the unearned revenue and it was a part of the cash from operations in that year. Hence, there will be an increase in cash flow from operations. In 2013, the revenue is earned, but there is no cash exchanged, and hence no effect of the cash from operations, ignoring taxes.

4. A is correct. An increase in the days sales payable would indicate the company is stretching out its payables, which would increase the cash from operations.

5. C is correct. The company can choose when to enter into short-term borrowing with the bank and reclassify its accounts payable into short-term financing. It will likely do so when cash flows are seasonally strong, thereby reducing operating cash flows, but increasing financing cash flows. On repayment, the cash outflow is treated as a financing activity (loan repayment) not an operating cash flow. The result is that the company can manipulate the timing of reported cash flows since the timing and extent of vendor financing is at management's discretion.

6. A is correct. Net cash from operations = 150,000 + 5,000 – 20,000 + 12,000 = 147,000

7. C is correct. Options A and B represent financing activities. Option C is an operating activity.

8. B is correct. Cash flows for the purchase of the shares in an affiliated company are cash from investing activities, therefore the net amount is -$550,000. Proceeds from issuance of bonds are financing activities. Cash flows from trading securities are operating activities

9. A is correct. Here is the relevant excerpt from Section 2.1 of the curriculum: "Cash outflows result from cash payments for inventory, salaries, taxes, and other operating- related expenses and from paying accounts payable. Additionally, operating activities include cash receipts and payments related to dealing securities or trading securities (as opposed to buying or selling securities as investments)."

10. B is correct. The investing activities include the purchase of equipment, and sale of the van. Gain from the sale of van is a part of net income. Dividends and interest paid are part of financing activities and salaries paid are part of operating activities. Therefore, net cash flow from investing is an outflow of $52,000.

11. C is correct. The only investing activity is the purchase of equipment; thus investing cash flow should decrease by $90,000. Financing activity comprises of both short term and long term debt and thus increases by $110,000. Salaries paid is an operating activity, which decreases operating cash flows by $20,000.

12. B is correct. In this case the company issues debt and receives cash. The cash is then used to buy land. Clearly these are cash-based transactions. The other two are examples of non-cash transactions. With stock dividend a company issues additional shares of its common stock to shareholders instead of cash.

13. B is correct. Significant non-cash transactions are generally disclosed as a separate note or as a supplementary schedule to the cash flow statement.

14. C is correct. Statement A is incorrect because under IFRS, interest paid is considered a financing cash flow or an operating cash flow. Statement B is incorrect because under U.S. GAAP, dividend received is considered an operating cash flow. Hence, statement C is correct.

15. A is correct. Interest paid must be categorized as an operating cash flow activity under U.S. GAAP, although it can be categorized as either an operating or financing cash flow activity under IFRS.

16. C is correct. Interest payments can be reported either as operating or financing cash flow under IFRS, but can only be reported as operating cash flow under U.S. GAAP. The interest payment was originally reported as financing activity under IFRS, but under U.S. GAAP, it would be an operating activity.
    Therefore, cash flow from financing activities would increase, and operating cash flows decrease by the same amount.

17. C is correct. Dividends received can be classified as either an operating or investing activity under IFRS, but can only be classified as an operating activity under U.S. GAAP.

18. C is correct. Under U.S. GAAP, bank overdrafts are not considered part of cash and cash equivalent. They are classified as financing cash flows.

19. B is correct. Dividends paid are classified as a financing cash flow under U.S. GAAP, while dividends received, interest paid and interest received are classified as operating cash flows. Under IFRS interest and dividends received may be classified as either operating or investing activities. Dividends and Interest paid may be classified as either operating or financing activities.

20. A is correct. The direct method of cash flow statement presentation shows the specific cash inflows and outflows that result in reported cash flow from operating activities (cash from customers, cash to suppliers, etc.). Companies using IFRS can decide to report interest and dividend receipts as either an investing or operating activity, whereas under U.S. GAAP, they

must report such income as an operating activity. The listed operating and investment activities indicate that the company reports under IFRS, using the direct method

21. B is correct. The direct method cash flow statement presents specific operating cash flows by source and use.

22. C is correct. Providing insight on the differences between net income and cash flow is a benefit of the indirect method. The indirect method starts with net income and integrates a series of adjustments to calculate cash flow from operations.

23. C is correct. Operating cash flows can be presented in a direct or indirect format.

24. A is correct. An increase in current asset is subtracted from net income and vice versa. An increase in current liability is added to net income.

25. C is correct. Increase in deferred income tax liability is added to net income. Remember: increase in a liability is a source of cash and is added; decrease in liability is a use of cash and is subtracted. See Exhibit 9 in Section 3.2.5.

26. A is correct. Since cash collections exceeded revenue by $5 million, the accounts receivable balance should come down by $5 million.

27. B is correct. PIA received the cash in 2012 when it recorded the unearned revenue and it was a part of the cash from operations in that year. In 2013, the revenue is earned, but there is no cash exchanged and hence no effect of the cash from operations, ignoring taxes.

28. A is correct. PIA received the cash in 2012 when it recorded the unearned revenue and it was a part of the cash from operations in that year. In 2013, the revenue is earned so it will increase the taxes which will decrease the cash from operations.

29. A is correct. Cash collected = Revenues – Increase in account receivables = 150,000 – (20,000 – 15,200) = 145,200.

30. B is correct. Cash paid to suppliers = 150 – 25 + 30 = 155

31. C is correct. Interest expense = Ending interest payable + Cash interest paid – beginning interest payable = 95.3 + 111 – 85.3 = 121.

32. C is correct. Understanding the accounting process may assist an analyst in identifying earnings manipulation, but it will not prevent the manipulation of earnings by management. It is important for analysts to understand the accounting process so they can make adjustments for items not reported and to aid in the assessment of management’s judgment of accruals and valuations.

33. C is correct.

$\text{Operating cash flow} =$
$\text{Net income} + \text{Depreciation and amortization} - \text{Increase in working capital}$
$\text{Operating cash flow} = 45{,}000 + 18{,}000 + 10{,}000 + (-1500 + 1800 + 1000) = \$74{,}300$

34. A is correct.
$\text{Ending balance} = \text{Beginning balance} + \text{Cash flows}$
$58{,}000 = 65{,}000 - 45{,}000 + 90{,}000 + \text{Investing cash flow}$
$\text{Investing cash flow} = (\$52{,}000)$

35. A is correct.
$\text{Cash collected} = \text{Revenue} - \text{Increase in Accounts receivable}$
$\text{Cash collected} = \$10 \text{ million} - \$4 \text{ million} = \$6 \text{ million}$

36. A is correct.
$\text{Cash paid to suppliers} = \text{Cost of goods sold} + \text{increase in inventory} - \text{increase in payables}$
$\text{Cash paid to suppliers} = 200{,}000 - 50{,}000 + 8{,}000 - 12{,}000 = \$146{,}000$

37. C is correct.
$\text{Ending inventory} = \text{Beginning inventory} + \text{purchases} - \text{cost of goods sold}$
$\text{Ending inventory} = 40{,}000 + 150{,}000 - 120{,}000 = 70{,}000$

38. A is correct.
$\text{Salary payable} = \text{Beginning salary payable} + \text{Salary expense} - \text{Cash paid}$
$\text{Salary payable} = 16{,}000 + 40{,}000 - 49{,}000 = 7{,}000$

39. A is correct.
$\text{Cash paid} = \text{Operating expenses} - \text{decrease in prepaid} - \text{increase in accrued}$
$\text{Cash paid} = 20 - 6 - 8 = 6$

40. C is correct.
$\text{Gain} = \text{Selling Price} - \text{Book Value}$
Historical cost:
Beginning value of machinery + machinery bought – machinery sold = Ending value of machinery
80 million + 14 million – 91 million = 3 million
Machinery sold = 3 million
Accumulated depreciation:
Beginning value of depreciation + depreciation expense – machinery depreciation = Ending value of depreciation
25 million + 7 million – 31 million = 1 million
Machinery depreciation = 1 million
Book value:
Book value = Historical cost – accumulated depreciation
Book value = 3-1 = 2 million
Selling price:
Selling price = Gain + Book Value
Selling price = 1.5 million + 2 million = 3.5 million

41. A is correct. Retiring long-term debt is a cash outflow related to financing activities.

42. C is correct.
$$\text{Ending retained earnings} = \text{Beginning retained earnings} + \text{net income} - \text{dividends paid}$$
Thus, if 'Ending retained earnings – Beginning retained earnings' is equal to $4 million, dividends paid is equal to 4 – 3 = 1.

43. B is correct.
Cash flow from financing activities:

Cash paid for dividends	$1,800
Cash paid to retire long term debt	$15,000
Total	$16,800

44. B is correct.

Add depreciation	$5 million
Subtract increase in current assets	($2 million)
Subtract decrease in current liabilities	($2 million)
Total adjustment	$1 million

45. B is correct. In step 2, all noncash items should be **removed** (not added) from aggregated revenues and expenses.

46. A is correct. Increase in accounts receivable must be subtracted from revenue adjusted for non-cash items.

47. C is correct. In a common size analysis of the statement of cash flows, the items of cash flow may be presented as a percentage of either total cash flow or net revenue.

48. B is correct. Cash flow is most likely negative for a growth stage company. A mature company tends to perform well and has stable cash flows. A declining profits company may not necessarily have negative cash flow.

49. A is correct. Identifying the major sources and uses of cash is the first step in cash flow statement analysis.

50. C is correct. The first two are approaches to develop common-size cash flow statements.

51. B is correct. A cash flow earnings index consistently below 1.0 could indicate potential problems in a company's quality of earnings.

52. B is correct. Debt payment ratio (CFO ÷ Cash paid for long-term debt repayment) shows the firm's ability to pay debts with operating cash flows

53. B is correct. Cash flow debt coverage ratio = CFO ÷ Total debt

112.2 ÷ 462.5 = 24.3%.

54. C is correct. FCFE = CFO – FCInv + Net Borrowing. An increase in net borrowing will increase FCFE, all else equal.

55. A is correct. FCFF = Net income + Non-cash charges + interest expense * (1 – Tax rate) – capital expenditures – working capital expenditures
FCFF = $45 + 12.3 + 2.6 * (1 - 0.3) - 15 - 8.1$ = $36.02 million

56. A is correct. FCFF = Net income + Non-cash charges + interest expense*(1 – tax rate) – capital expenditures – working capital expenditures
FCFF = $500000 + 30000 + 50000 * (1 - 0.35) - 180000 - 0$ = 382,500

57. B is correct.

	$ millions
Net Income	180.0
Plus: Non-cash Charges	30.4
Plus: Interest Expense × (1 – Tax Rate)	56×(1-0.3) = 39.2
Less: Capital Expenditures	(68.6)
Less: Working Capital Expenditures	(26)
FCFF	155

58. B is correct.
$\text{FCFF} = \text{NI} + \text{NCC} + \text{Interest}\ (1 - \text{Tax Rate}) - \text{FC Inv} - \text{WC Inv}$
$\text{FCFF} = 45{,}000 + 4{,}000 + 5{,}000\ (1 - 0.4) - 20{,}000 - 9{,}000 = \$23{,}000$

59. B is correct.
$\text{FCFE} = \text{CFO} - \text{FCInv} - \text{Net debt repayment}$
$\text{FCFE} = 39{,}000 - 9.000 - 10{,}000 = 20{,}000$

60. A is correct.
The debt coverage ratio measures financial risk.

61. A is correct. Free cash flow to firm = CFO + Interest (1 – Tax Rate) – Fixed Capital Investment. Note that working capital investment is already included in CFO.

