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BSA 2

Multiple Choice Questions

1. Which of the following items is included in the adjustment of net income to obtain cash flow from operating activities?

- A. Depreciation expense for the period.
- B. The change in deferred taxes.
- C. The amount by which equity income recognized exceeds cash received
- D. All of the above.

2. Which statement is true for gains and losses from capital asset sales?

- A. They do not affect cash and are excluded from the statement of cash flows.
- B. They are included in cash flows from operating activities.
- C. They are included in cash flows from investing activities.
- D. They are included in cash flows from financing activities.

3. Which of the following assets is included in the adjustment of net income to obtain cash flow from operating activities?

- A. Accounts receivable.
- B. Inventory.
- C. Prepaid expenses.
- D. All of the above.

4. Which of the following current liability accounts is included in the adjustment of expenses to obtain cash flow operating activities?
- A. Accounts payable.
 - B. Notes payable and current maturities of long-term debt.
 - C. Accrued liabilities,
 - D. Both (a) and (c)

Items 5 to 8 are based on the following data

The following information is available for Ubbie's Jewelry and Gift Store:

Net income	P5,000
Depreciation expense	2,500
Increase in deferred tax liabilities	500
Decrease in cash	3,000
Increase in marketable securities	1,000
Decrease in accounts receivable	2,000
Increase in inventories	9,000
Decrease in accounts payable	5,000
Increase in accrued liabilities	1,000
Increase in property and equipment	14,000
Increase in short-term notes payable	19,000
Decrease in long-term notes payable	4,000

Use the indirect method to answer the questions.

5. What is net cash flow from operating activities?

- A. (3,000)
- B. (1,000)
- C. P 5,000
- D. P13,000

6. What is net cash flow from investing activities?

- A. P 14,000
- B. (P14,000)
- C. P 21,000
- D. (P16,000)

7. What is net cash flow from financing activities?

A. P 15,000

B. P(15,000)

C. P 17,000

D. P(14,000)

8. What is the change in cash?

A. P(3,000)

B. P3,000

C. P2,000

D. P(2,000)

9. Which of the following is an inflow of cash?

A. Funds spent in normal business operations.

B. The purchase of a new factory.

C. The sale of the firm's bond.

D. The retirement of the firm's bonds.

10. Depreciation is a source of cash inflow because

A. it is a tax-deductible noncash expense.

B. it supplies cash for future asset purchases.

C. it is a tax-deductible cash expense.

D. it is a taxable expense.

11. Assuming a tax rate of 35%, depreciation expenses of P400,000 will

- A. reduce income by P140,000.
- B. reduce taxes by P140,000.
- C. reduce taxes by P400,000.
- D. have no effect on income or taxes, since depreciation is not a cash expense.

12. A statement of cash flows allows a financial analyst to determine

- A. whether a cash dividend is affordable.
- B. how increases in asset accounts have been financed.
- C. whether long-term assets are being financed with long-term or short-term financing.
- D. all of the given choices.

13. Assuming a tax rate of 40%, the after-tax cost of a P200,000 dividend payment is

- A. P200,000.
- B. P70,000.
- C. P130,000.
- D. None of the above.

14. The statement of cash flows not include which of the following section?

- A. Cash flows from operating activities
- B. Cash flows from sales activities
- C. Cash flows from investing activities
- D. Cash flows from financing activities

15. Which of the following would represent a use of funds and indirectly a reduction in cash balance,.

- A. An increase in inventories
- B. A decrease in marketable securities
- C. An increase in accounts payable
- D. The sale of new bonds by the firm

16. A firm's purchase of plant and equipment would be considered a

- A. use of cash for financing activities.
- B. use of cash for operating activities.
- C. source of cash for investment activities.
- D. use of cash for investment activities.

Problem 1 (Statement of Cash Flows)

Luis Shop had cash flows from investing activities of P2,567,000 and cash flows from financing activities of P3,459,000. The balance in the firm's cash account was P950,000 at the beginning of 2015 and P1,025,000 at the end of the year. **Calculate Luis Shop's cash flow from operations for 2015.**

LUIS SHOP Statement of Cash Flows For Year Ended December 31, 2015	
Cash Flow from Operating Activities	P(5,951,000)
Cash flow from investing activities	2,567,000

Cash flow from financing activities	3,459,000
Net increase	P75,000
Cash balance-01/01/15	950,000
	P1,025,000

Problem 2 (Free Cash Flow)

You are considering an investment in East Corporation and want to evaluate the firm's free cash flow. From the income statement, you see that East Corporation earned an EBIT of P62 million, paid taxes of P17 million, and its depreciation expense was P5 million. Fixed assets increased by P32 million from 2014 to 2015. The firm's current assets increased by P20 million and spontaneous current liabilities increased by P12 million. *Calculate East Corporation's operating cash flow, investment in operating capital and free cash flow for 2015.*

Answer:

EBIT	P 62,000,000
Taxes	(17,000,000)
Depreciation	<u>5,000,000</u>
OCF	<u>P 50,000,000</u>

Current assets	P 20,000,000
Less: liabilities	(<u>12,000,000</u>)
Net Operating Working Capital	<u>P 18,000,000</u>

Gross Fixed Assets	P 32,000,000
Add: Net Operating Working Capital	<u>8,000,000</u>
Investment in Operating Capital	<u>P 40,000,000</u>
OCF	P50,000,000
IOC	<u>40,000,000</u>
Free Cash Flow	<u>P10,000,000</u>

Problem 3 (Free Cash Flow)

Tiffany Corporation reported free cash flows for 2015 of P23 million and investment in operating capital of P13 million. The firm listed P8 million in depreciation expense and P17 million in taxes on its 2015 income statement. ***Calculate Tiffany Corporation's 2015 EBIT.***

Answer:

Free cash flow	P 23,000,000
IOC	<u>13,000,000</u>
Operating Cash Flow	P 36,000,000
Depreciation	<u>(8,000,000)</u>
Net Operating before tax	P 28,000,000
Taxes	<u>17,000,000</u>
EBIT	<u>P 45,000,000</u>

Problem 4 (Statement of Cash Flows)

Janice Company has net cash flow from financing activities for the last year of P20 million. The company paid P105 million in dividends last year. During the year, the change in notes payable (balance) was P23 million and the change in common and

preferred stock was P0. The end year balance for long-term debt was P185 million.
Calculate the beginning of year balance for long-term debt.

Answer:

End year balance	P105,000,000
Dividends	20,000,000
Notes payable balance	<u>(23,000,000)</u>
Total	P102,000,000

Long term debt, Ending	P185,000,000
Less: long term debt during the year	<u>102,000,000</u>
Long term debt, beginning	<u>P 83,000,000</u>

Problem 5 (Free Cash Flow)

Gabrielle Corporation had free cash flow during 2014 of P12 million. The change in gross fixed assets on Gabrielle's statement of financial position during 2014 was P10 million and the change in net operating working capital was P14 million. Using this information, fill in the blanks on Gabrielle's income statement below.

GABRIELLE CORPORATION	
Income Statement for the Year Ending December 31, 2014	
(In millions of pesos)	
	2014
Net Sales	P 107100,000
Less: Cost of goods sold	(75,600,000)
Gross profit	P 31,500,000

Less: Depreciation	(6,000,000)
Earnings before interest and taxes(EBIT)	P25,000,000
Less: interest	(0.00)
Earning Before Tax	P25,000,000
Less: taxes (P25k*25%)	(6,375,000)
Net Income	P19,125,000

Problem 6 (Worksheet with Financial Statement)

Shown below are partial financial statements for Garcias Health Care, Inc. Fill in the blanks on the four financial statements

Garcia's Health Care, Inc. Statement of Financial Position as of Dec. 31, 2014 and 2015 (in million pesos)		
Assets	2014	2015
Current assets:		
Cash and marketable securities	P395	P421
Accounts receivable	1,020	1, 091

Inventory	1,581	1,760
Total	P2,996	3,290
Fixed assets:		
Gross plant and equipment	P4,743	P5,812
Less: Depreciation	640	840
Net plant and equipment	4,103	4,972
Other long-term assets	790	892
Total	4,893	5,864
Total assets	P7,889	P9.154
Liabilities and Equity		
Current liabilities:		
Accrued wages and taxes	P242	P316
Accounts payable	791	867
Notes payable	714	872
Total	P1,747	P2,055
Long-term debt:	3,005	3,090

Total liabilities	P4,752	P5,145
Stockholders' equity:		
Preferred stock (25 million shares)	60	60
Common stock and paid-in surplus (200 million shares)	637	637
Retained earnings	2,440	3,312
Total	3,137	4,009
Total liabilities and equity	P7,889	P9,154

Garcia's Health Care, Inc. Income Statement for the year ended Dec. 31, 2014 and 2015 (in million pesos)		
	2014	2015
Net sales	P4,348	P4,980
Less: Cost of goods sold	2,135	2,317
Gross profits	2,213	2,609
Less: Depreciation	191	200
Earnings before interest and taxes (EBIT)	2,022	2,409

Less: Interest	285	(315)
Earnings before taxes (EBT)	1,737	2,094
Less: Taxes	632	767
Net income	1,105	1,327
Less: Preferred stock dividends	60	60
Net income available to common stockholders	1,045	1,267
Less: Common stock dividends	395	395
Addition to retained earnings	650	872
Per (common) share data:		
Earnings per share (EPS)	P5,230	P6,340
Dividends per share (DPS)	1,980	1,980
Book value per share (BVPS)	3,190	3,190
Market value (price) per share (MVPS)	P22,50	P26,850

	2015
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A. Cash flows from operating activities	
Net income	P1,327
Additions (sources of cash):	
Depreciation	P200
Increase accrued ryages and taxes	74
Increase in accounts payable	76
Subtractions (uses of cash):	
Increase in accounts receivable	89
Increase in inventory	179
Net cash flow from operating activities	P 1,409
B. Cash flows from investing activities	
Subtractions:	
Increase fixed assets	P1,069
Increase in other long-term assets	102
Net cash flow from investing activities	P1,171
C. Cash flows from financing activities Additions:	
Increase in notes payable	P158
Increase in long-term debt	85

Increase in common and preferred stock	0
Subtractions:	
Pay dividends	455
Net cash flow from financing activities	P212
Net change in cash and marketable securities	(P 26)

I. Questions

1. Give four purposes of the cash flow statement.

- a) provide relevant information about a company's cash receipts and cash payments during an accounting period that is useful in evaluating the preceding items.
- b) the changes in net assets of an enterprise of an enterprise and its ability to affect the amounts and timing of cash flows in order to adopt to changing circumstances and opportunities
- c) the ability of the enterprise to generate cash and cash equivalents and enables the users to develop models to assess and compare the present value of the future cash flows of different enterprises
- d) it enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

2. What information is included in a statement of cash flows that is not available in comparative income statements, statements of financial position, and retained earnings statements for the same reporting period?

3. What is the most important source of cash for many successful companies?

- a) Operations
- b) Financing
- c) Investments

4. How is it possible for cash to decrease when income is high?

5. Why are transactions involving accounts payable not considered to be financing activities?

- The transactions in financing activities are generally those from which the funds are collected, say for example equity issued, while in the operating activities, the activities related to day to day operations are mentioned, hence accounts payable activities are not shown in a Financing activity but are shown in operating activities head

6. If an asset is sold at a loss, why is the loss added back to net income when computing the cash provided by operating activities under the "indirect method"?

7. Identify three major categories of transactions that may result in increases in cash, and state a general conclusion about the circumstances in which an increase in cash would actually result

- a) Operations Activities
- b) Financing Activities
- c) Investments Activities

8. Identify three major categories of transactions that may result in decreases in cash, and state a general conclusion about the circumstances in which a decrease in cash would actually result.

9. Define "noncash investing and financing transactions." How are they presented in the cash flow statement?

- non-cash investing and financing activities is important for the users of financial statements because they have a significant impact on the current and future performance in terms of revenues, profits and the ability of the entity to generate positive cash flows.

10. Is it possible for a net loss for a period to result in a source of cash for that same period? Explain.

11. What is the relationship between the change in cash during a period and the three types of cash flows operating, investing and financing?

- Cash flow from operating, arise from activity a business uses to produce net income. Cash flow from investing are business transaction related in investments in long-term assets. Cash flow from financing are cash transactions related to the business raising money from debt or stock, or repaying that debt.

12. Explain the treatment of the following transactions in a statement of cash flows:

- a) Declaration of a cash dividend to be paid in the next period.
- b) Declaration and payment of a cash dividend in the current period.

13. The controller of Lei's Company, your audit client, argues that the refunding of outstanding 10% debt by issuing 8% debt does not materially affect the company's financial position, because the difference between the net amount of debt outstanding is not great (i.e., not material in relation to the other statement of financial position items). The controller argues, therefore, that the transaction does not need to be included in the cash flow, statement, particularly since cash is not affected. Do you agree or disagree with the controller? Why?

14. Winter, Inc.'s income statement includes income tax expense of P150,000, of which P112,500 was paid by year-end and P37,500 was deferred because of the use of accelerated cost recovery for income tax purposes and straight-line depreciation for financial reporting. How will these facts affect the presentation of "cash provided by operating activities" in the cash flow statement?

15. A plant asset was sold at a loss during the current year. The loss was included in income before extraordinary item on the enterprise's income statement. Explain the proper presentation of this transaction in the cash flow statement.

16. What are the three major sections on a statement of cash flows, and what are the general rules that determine the transactions that should be included in each section?

- a) Operating activities
- b) Investing activities
- c) Financing activities

17. Why is interest paid on amounts borrowed from banks and other lenders considered to be an operating activity while the amounts borrowed are financing activities?

18. If an asset is sold at a gain, why is the gain deducted from net income when computing the net cash provided by operating activities under the indirect method?

- Since the entire cash proceeds from the sale of a noncurrent asset appear as a cash inflow from investing activities, the gain must be deducted from net income to avoid double counting a portion of those proceeds.

19. How do the direct and the indirect methods differ in their approach to computing the net cash provided by operating activities?

- The direct method determines changes in cash receipts and payments, which are reported in the cash flow from the operations section. The indirect method takes the net income generated in a period and adds or subtracts changes in the asset and liability accounts to determine the implied cash flow

20. If the balance in Accounts Receivable increases during a period, how will this increase be recognized using the indirect method of computing the net cash provided by operating activities?

- An increase in the Accounts Receivable account must be subtracted from the net income under the indirect method because this is an increase in a non cash asset. A sale of equipment for cash would be classified as an investing activity.

21. If the balance in Accounts Payable decreases during a period, how will this decrease be recognized using the direct method of computing the net cash provided by operating activities?

22. Would a sale of equipment for cash be considered a financing activity or an investing activity? Why