Chapter 1 Overview of Financial Management

MULTIPLE CHOICE

1. Which of the following statements about financial management is false?
   a. looking after trade payables and corporate accounting is a responsibility of the controller
   b. the profit for the year is the difference between revenue and gross profit
   c. the treasurer is responsible for raising funds
   d. an important objective of financial management is to ensure that the return on assets is greater than the cost of borrowing

   ANS: B PTS: 1 REF: 29

2. Which of the following statements about financial management is true?
   a. internal financing is obtained from banks and investors
   b. the liquidity objective deals with the payment of dividends
   c. operating decisions deal with better utilization of non-current assets
   d. the stability objective is related to the financial structure of a business

   ANS: D PTS: 1 REF: 17

3. Which of the following statements about financial management is false?
   a. the treasurer is responsible for trade and other payables and corporate accounting
   b. external financing is obtained from investors
   c. internal financing is obtained from retained earnings and depreciation/amortization
   d. two ways to improve net profit are the use of productivity indicators and planned downsizing

   ANS: A PTS: 1 REF: 12

4. What is the ultimate objective of financial management?
   a. to make sure the ROA is higher than ROR
   b. to obtain a higher return on revenue than on assets
   c. to ensure that ROA is higher than the cost of financing
   d. to collect trade receivables faster than the payment of trade and other payables

   ANS: C PTS: 1 REF: 9

5. Which of the following responsibilities does the controller have?
   a. general accounting
   b. tax administration
   c. investor relations
   d. analyzing short- and long-term borrowing sources

   ANS: A PTS: 1 REF: 12

6. Which of the following is considered an "efficiency" financial objective?
   a. ability to meet short-term financial commitments
   b. cost of borrowed funds
   c. return on trade receivables
   d. return on revenue

   ANS: D PTS: 1 REF: 15

7. What is profit for the year used for?
   a. to pay executive bonuses
   b. to pay interest on debt
   c. to pay dividends
   d. to pay employee salaries

   ANS: C PTS: 1 REF: 17

8. What is a source of internal financing?
   a. revenue
   b. depreciation/amortization
   c. mortgages
   d. long-term borrowings

   ANS: B PTS: 1 REF: 18

9. What do investing decisions deal with?
   a. cost of borrowed funds
   b. planned downsizing
   c. buying non-current assets
   d. financing mix

   ANS: C PTS: 1 REF: 20

10. What type of decision is the management of working capital?
    a. an operating decision
    b. an investing decision
    c. a financing decision
    d. a capital budgeting decision

    ANS: A PTS: 1 REF: 24

11. Which item does average collection period measure?
    a. discounts on cash sales
    b. inventories
    c. trade and other payables
    d. trade receivables

    ANS: D PTS: 1 REF: 25

12. How is gross profit determined?
    a. deduct cost of sales from revenue
    b. deduct operating expenses from revenue
    c. deduct income tax expense from profit before taxes
    d. deduct distribution costs from operating profit

    ANS: A PTS: 1 REF: 28

13. How is ROR calculated?
    a. divide income before taxes by revenue
    b. divide cost of sales by revenue
    c. divide revenue by cost of sales
    d. divide profit for the year by revenue

    ANS: D PTS: 1 REF: 16

14. Which of the following statements is true?
    a. a company is a poor investment when the ROR is greater than the cost of financing
    b. a company is a good investment when the ROA is greater than the cost of financing
    c. a company is a poor investment when the ROA is greater than the cost of capital
    d. a company is a good investment when the ROR is greater than the cost of financing

    ANS: B PTS: 1 REF: 9

15. What does the "activity involved in raising funds and buying assets in order to obtain the highest possible return" define?
    a. accounting
    b. marketing management
    c. general management
    d. financial management

    ANS: D PTS: 1 REF: 9

16. Why is it important for managers to ask, "How are we doing?"?
    a. it is required by their employment contract
    b. investors want to know about a company's financial performance
    c. interest groups have illegitimate and corresponding objectives
    d. companies always make a profit

    ANS: B PTS: 1 REF: 9

17. The person responsible for credit and collection in a company is the:
    a. bookkeeper
    b. controller
    c. accountant
    d. treasurer

    ANS: B PTS: 1 REF: 13

18. What is the term for the relationship between assets and profit for the year?
    a. stability
    b. efficiency
    c. liquidity
    d. prosperity

    ANS: B PTS: 1 REF: 15

19. ROA is a measure of:
    a. efficiency
    b. liquidity
    c. fluency
    d. prosperity

    ANS: A PTS: 1 REF: 15

20. What decision is being made when a company decides whether to arrange a mortgage, sell bonds, or issue shares?
    a. a financing decision using internal financing
    b. an operating decision using internal financing
    c. a financing decision using external financing
    d. an operating decision using external financing

ANS: C PTS: 1 REF: 19

21. Which of the following is a demonstration of the matching principle?
    a. paying dividends to shareholders
    b. ensuring that Assets = Liabilities + Equity
    c. selecting the most appropriate financing source when buying an asset
    d. systematically cutting overhead costs

ANS: C PTS: 1 REF: 22

22. What are decisions related to accounts on the statement of income called?
    a. accounting decisions
    b. investing decisions
    c. financing decisions
    d. operating decisions

ANS: D PTS: 1 REF: 24

23. What is a method used to measure and improve organizational performance called?
    a. planned downsizing
    b. productivity indicator
    c. financing mix
    d. demassing

ANS: B PTS: 1 REF: 26

24. What will likely result from rewarding quality work instead of fast work?
    a. decreased profitability
    b. improved gross profit and bottom line
    c. higher costs
    d. decreased worker pride

ANS: B PTS: 1 REF: 27

25. What does stability refer to?
    a. revenue structure
    b. working capital structure
    c. cost structure
    d. financial structure

ANS: D PTS: 1 REF: 17

26. Which of the following statements about financial management is false?
    a. it ensures that a company's ROA is higher than the cost of financing
    b. it is important to have all operating managers participate in making financing decisions
    c. it ensures that a company uses its resources in the most efficient and effective way
    d. financial management deals with raising funds in addition to buying and utilizing assets

ANS: B PTS: 1 REF: 9

27. Which of the following are considered "revenue accounts"?
    a. dividends paid
    b. gross sales
    c. mortgage payable
    d. cost of sales

ANS: B PTS: 1 REF: 28

28. Which of the following statements concerning non-financial managers is false?
    a. managers responsible for resources or budgets should be familiar with the language of finance
    b. business decisions do not affect the financial performance of the organization
    c. all managers are really financial managers because their actions ultimately affect the financial statements
    d. capital budgeting, ratio analysis, and break-even are financial tools

ANS: B PTS: 1 REF: 13

29. What does weighted average cost of capital deal with?
    a. investments made only by lenders
    b. long-term financing
    c. short-term borrowings
    d. investments made only by shareholders

ANS: B PTS: 1 REF: 22

30. Which of the following is used to calculate the gross profit?
    a. extraordinary expenses
    b. operating expenses
    c. revenue
    d. cost of inventory

ANS: C PTS: 1 REF: 28

31. Which of the following are not usually interested in reading a company’s financial statements?
    a. investors
    b. lenders
    c. journalists
    d. suppliers

ANS: C PTS: 1 REF: 9

32. Which of the following statements is true?
    a. lenders use financial statements to decide whether or not to sell a company their products
    b. investors use financial statements to decide whether or not to buy a company's products
    c. the marketing department is not interested in the sales figure in the financial statements
    d. managers use financial statements to make decisions about their company

ANS: D PTS: 1 REF: 10

33. What is income tax expense deducted from in order to determine profit for the year?
    a. revenue
    b. profit before taxes
    c. distribution expenses before taxes
    d. profit before cost of sales

ANS: B PTS: 1 REF: 15

34. What is the term for raising funds and buying assets in order to obtain the highest possible return?
    a. financial management
    b. materials management
    c. operations management

d. asset management

ANS: A PTS: 1 REF: 9

35. Which of the following is used to calculate the weighted average cost of capital?
   a. mortgage payable
   b. accrued expenses
   c. profit for the year
   d. trade and other payables

ANS: A PTS: 1 REF: 22

36. Which of the following is not a reason why financial management is important for business owners?
   a. it lets owners know exactly what will happen in the coming year
   b. it lets owners know how much cash is on hand
   c. it allows managers to determine if operating costs are efficient
   d. it gives information about financial performance

ANS: A PTS: 1 REF: 10

37. Which person is responsible for raising capital dollars in a company?
   a. manager
   b. owner
   c. treasurer
   d. controller

ANS: C PTS: 1 REF: 12

38. What is used to measure liquidity?
   a. current debt and equity
   b. current assets and equity
   c. current assets and long-term borrowings
   d. current assets and current liabilities

ANS: D PTS: 1 REF: 16

39. Which of the following is correct?
   a. financing decisions include how much to spend on distribution costs
   b. investing decisions include what capital assets to acquire
   c. operating decisions include whether to obtain funds from shareholders and lenders
   d. financing decisions include how much to spend on administrative expenses

ANS: B PTS: 1 REF: 20-24

40. Which of the following statements is false?
   a. managers are responsible for investing decisions
   b. ratio analysis is a tool for analyzing performance
   c. managers are responsible for resources
   d. managers are not responsible for operating budgets

ANS: D PTS: 1 REF: 10

41. Which of the following responsibilities does the controller have?
   a. general accounting
   b. insurance
   c. dividend payments

d. pension plans

ANS: A PTS: 1 REF: 13

42. Who requires skills in reading financial statements, capital budgeting and break-even and cost benefit analysis?
a. the shipping clerk in a distribution operation
b. the general public
c. operating managers
d. elected politicians

ANS: C PTS: 1 REF: 13

43. What is a major goal of an operating manager?
a. improve relations with investors
b. formulate budgeting policies
c. raise funds from investors
d. improve financial performance

ANS: D PTS: 1 REF: 13

44. What must be included in plans if they are to be expressed in measurable terms?
a. terms like "good", "medium", and "bad"
b. specific expressions of hopes
c. a reference to the firm’s well-being
d. quantities and dollar amounts

ANS: D PTS: 1 REF: 14

45. What do managers examine to assess the impact of their decisions on the financial well-being of their organization?
a. general corporation correspondence
b. statistical reports
c. financial pages of newspapers
d. financial statements

ANS: D PTS: 1 REF: 19

46. Which of the following is an external financing source?
a. mortgage payable
b. profit for the year
c. retained earnings
d. depreciation/amortization

ANS: A PTS: 1 REF: 19

47. Which of the following statements is false?
a. marketing managers are interested in manufacturing overhead
b. production and operations managers are interested in the cost of producing a product
c. he general manager is interested in how much profit for the year the company earns
d. human resources managers are interested in the costs related to payroll benefits and training

ANS: A PTS: 1 REF: 13

48. Which activity is related to the query "Where will our external funds come from?"?

a. financing
b. operating
c. investing
d. operating and financing

ANS: A PTS: 1 REF: 22

49. Which of the following are “sources” of funds?
a. land
b. automobile
c. share capital
d. machinery and equipment

ANS: C PTS: 1 REF: 19

50. Which of the following is an internal source of funds?
a. mortgages
b. retained earnings
c. common shares
d. bonds

ANS: B PTS: 1 REF: 18

51. Which of the following is an external source of funds?
a. mortgages
b. decreased receivables
c. depreciation/amortization
d. retained earnings

ANS: A PTS: 1 REF: 19

52. Which of the following statements is TRUE?
a. profitable operations are a use of funds
b. trade credit is a source of funds
c. dividends paid are a source of funds
d. investments in all types of assets are sources of funds

ANS: B PTS: 1 REF: 22

53. Which of the following statements is false?
a. deciding on the amount of operating expenses is an operating decision
b. deciding on the amount of long-term borrowings is an investing decision
c. operating decisions are related to amounts shown on the statement of income
d. investing decisions are related to assets

ANS: B PTS: 1 REF: 22

54. Which of the following is not a source of financing?
a. equipment vendors
b. investment bankers
c. dividends
d. commercial banks

ANS: C PTS: 1 REF: 22

55. Which of the following are “forms” of financing?

a. installment loans
b. unsecured short-term borrowings
c. inventories
d. term loans

ANS: C PTS: 1 REF: 22

56. Which of the following is an investing decision?
a. buying inventory
b. buying non-current assets
c. selling trade receivables
d. selling a bond

ANS: B PTS: 1 REF: 20

57. What is the correct matching?

Words:
(a) non-current assets
(b) current assets
(c) gross profit
(d) profit for the year
(e) profit before taxes

Definitions:
(1) statement of financial position accounts such as cash, trade receivables, and inventories
(2) statement of financial position accounts such as land, buildings, equipment, machinery
(3) difference between gross profit and other costs
(4) difference between profit before taxes and income tax expense
(5) difference between revenue and cost of sales
a. a-2, b-1, c-5, d-4, e-3
b. a-2, b-1, c-4, d-3, e-5
c. a-1, b-2, c-3, d-4, e-5
d. a-2, b-1, c-3, d-4, e-5

ANS: A PTS: 1 REF: 18-19|28-29

58. What is an increase in non-current assets between two accounting periods considered?
a. cash outflow
b. source of cash
c. cash inflow
d. revenue

ANS: A PTS: 1 REF: 10

59. Which of the following is a non-current liability?
a. trade receivables
b. inventories
c. mortgage payable
d. goodwill

ANS: C PTS: 1 REF: 22

60. What decisions does the matching principle deal with?
a. working capital decisions

b. financing decisions
c. investing decisions
d. operating decisions

ANS: B PTS: 1 REF: 22

61. Which of the following statements is TRUE?
a. income taxes increase the cost of borrowing
b. the terms “interest” and “dividends” are interchangeable
c. preferred dividends are deductible for tax purposes
d. finance costs are deductible for tax purposes

ANS: D PTS: 1 REF: 22

62. Which of the following is considered a source of cash for not-for-profit organizations?
a. operating activities
b. investing activities
c. research and development activities
d. reduction in debt accounts

ANS: A PTS: 1 REF: 11

63. When does cash flow increase?
a. inventories are reduced
b. trade receivables are increased
c. revenue is reduced
d. non-current assets are purchased

ANS: A PTS: 1 REF: 24

TRUE/FALSE

1. An important objective of financial management is to ensure that the cost of borrowed funds is higher than the return on assets.

ANS: F PTS: 1

2. Efficiency means the ability of a firm to meet its short-term obligations.

ANS: F PTS: 1

3. Financial management ensures that operating managers formulate accounting and financial policies that are clearly defined.

ANS: F PTS: 1

4. Financial management deals with two things: raising funds and buying and utilizing assets in order to gain the highest possible return.

ANS: T PTS: 1

5. The controller is the person responsible for establishing the accounting and financial reporting policies and procedures.

ANS: T PTS: 1

6. The treasurer is the person responsible for budgets and analysis.

ANS: F PTS: 1

7. One key function of the treasurer is “investor relations”.

ANS: T PTS: 1

8. Efficiency measures the relationship between profit for the year (outputs) generated and assets employed (inputs).

ANS: T PTS: 1

9. Liquidity focuses on the ability of a firm to grow (i.e., revenue, profit for the year, etc.).

ANS: F PTS: 1

10. Stability deals with the relationship between debt and equity.

ANS: T PTS: 1

11. Funds obtained from “external financing” include depreciation/amortization and retained earnings.

ANS: F PTS: 1

12. Reducing working capital accounts such as trade receivables and inventories can generate funds “internally”.

ANS: T PTS: 1

13. Capital shares can be considered an “external” source of funds.

ANS: T PTS: 1

14. Investing decisions relate to borrowing funds from investors.

ANS: F PTS: 1

15. Investing decisions has to do with the management of current assets.

ANS: F PTS: 1

16. Financing decisions focus on long-term borrowings.

ANS: T PTS: 1

17. The matching principle focuses on the process of matching current assets to long-term assets.

ANS: F PTS: 1

18. A commercial bank is a “form” of financing.

ANS: F PTS: 1

19. A term loan and mortgage are considered “forms” of financing.

ANS: T PTS: 1

20. A component of “financing decisions” is determining the proportion of funds that should be raised from lenders versus owners.

ANS: T PTS: 1

21. The matching principle is the process of selecting the most appropriate financing source when selling an asset.

ANS: F PTS: 1

22. Financing mix is an important component of “financing decisions”.

ANS: T PTS: 1

23. Revenue and cost of sales are accounts shown on the statement of income that deal with operating decisions.

ANS: T PTS: 1

24. Planned downsizing is a recession-driven technique to add management layers in organizational charts to cut costs.

ANS: F PTS: 1

25. Gross profit is the difference between revenue and cost of sales.

ANS: T PTS: 1

26. Decisions affecting gross profit are found in two categories of expenses: distribution costs and cost of sales.

ANS: F PTS: 1

27. Two accounts that affect profit for the year are distribution costs and administrative expenses.

ANS: T PTS: 1

28. The purpose of the Sarbanes-Oxley Act was to set new standards for all public company boards, management and public accounting firm.

ANS: T PTS: 1

29. Corporate governance has to do with the management of federal and provincial government organizations.

ANS: F PTS: 1

30. Corporate culture is a management wave that appeared in the early 1980s and has to do with a shared system of values and beliefs within an organization.

    ANS: T PTS: 1

31. A key role of the *International Accounting Standards Committee* is to review and reinforce the convergence of global management standards for all publicly owned corporations.

    ANS: F PTS: 1

COMPLETION

1. Financial management is the activity that has to do with raising funds and buying ____________________ in order to obtain the highest possible return.

   ANS: assets

   PTS: 1

2. The ____________________ is the person responsible for establishing the accounting and financial reporting policies and procedures.

   ANS: controller

   PTS: 1

3. The ____________________ is the person responsible for raising funds.

   ANS: treasurer

   PTS: 1

4. Financial management activities are carried out by three individuals, the ____________________, the controller and managers.

   ANS: treasurer

   PTS: 1

5. General accounting is the responsibility of the ____________________.

   ANS: controller

   PTS: 1

6. ____________________ means productivity of assets, which can be measured by the relationship between profit for the year and revenue.

   ANS: Efficiency

   PTS: 1

7. ____________________ is a financial objective that shows if a firm has the ability to meet its short-term obligations.

ANS: Liquidity

PTS: 1

8. There are four financial objectives: efficiency, liquidity, ____________________ and stability.

ANS: prosperity

PTS: 1

9. ____________________is a financial objective that deals with the relationship between debt and equity.

ANS: Stability

PTS: 1

10. There are three types of business decisions: investing, operating and ____________________.

ANS: financing

PTS: 1

11. Funds obtained from retained earnings and depreciation/amortization are considered ____________________ financing.

ANS: internal

PTS: 1

12. Funds obtained from investors are considered ____________________ decisions.

ANS: financing

PTS: 1

13. ____________________ decisions relate to the acquisition of non-current assets.

ANS: Investing

PTS: 1

14. The acquisition of a business and the purchase of non-current assets are considered ____________________ decisions.

ANS: investing

PTS: 1

15. ____________________ assets are statement of financial position accounts such as land, buildings and equipment.

ANS: Non-current

PTS: 1

16. The ___________________ principle deals with the process of selecting the most appropriate financing source when buying a asset.

ANS: matching

PTS: 1

17. _____________________ provide funds to a business in the form of trade and other payables.

ANS: Suppliers

PTS: 1

18. "Forms" of financing are financing _____________________ used to buy assets.

ANS: instruments

PTS: 1

19. _____________________ decisions deal with many accounts appearing on the statement of income.

ANS: Operating

PTS: 1

20. _____________________ is a recession-driven technique that was used to remove management layers from organizational charts to cut costs.

ANS: Demassing

PTS: 1

21. Gross profit is the different between revenue and _____________________.

ANS: cost of sales

PTS: 1

22. Profit for the year is the difference between _____________________and income tax expense.

ANS: profit before taxes

PTS: 1

23. _____________________ is defined as the process of decision-making and the process by which decisions are implemented (or not implemented).

ANS: Governance

PTS: 1

MATCHING

Match each term with the correct definition.

a. controller
b. treasurer
c. efficiency
d. liquidity
e. prosperity

1. external activities
2. internal activities
3. revenue
4. return on sales
5. meeting short-term commitments

1.	ANS: B	PTS: 1
2.	ANS: A	PTS: 1
3.	ANS: E	PTS: 1
4.	ANS: C	PTS: 1
5.	ANS: D	PTS: 1

Match each term with the correct definition.

a. efficiency
b. prosperity
c. internal financing
d. external financing
e. stability

6. relationship between equity and debt
7. retained earnings
8. revenue, profit for the year, working capital
9. profit for the year ÷ revenue
10. mortgage

6.	ANS: E	PTS: 1
7.	ANS: C	PTS: 1
8.	ANS: B	PTS: 1
9.	ANS: A	PTS: 1
10.	ANS: D	PTS: 1

Match each term with the correct definition.

a. investing decisions
b. efficiency
c. operating decision
d. financing decision
e. liquidity

11. machinery and equipment
12. profit for the year
13. return on revenue
14. dividends

15. working capital

11. ANS: A PTS: 1
12. ANS: C PTS: 1
13. ANS: B PTS: 1
14. ANS: D PTS: 1
15. ANS: E PTS: 1

Match each term with the correct definition.

a. accounting
b. investor relations
c. dividends
d. return on assets
e. cost of capital

16. controller
17. efficiency
18. shareholders
19. treasurer
20. investors

16. ANS: A PTS: 1
17. ANS: D PTS: 1
18. ANS: C PTS: 1
19. ANS: B PTS: 1
20. ANS: E PTS: 1

Match each term with the correct definition.

a. current asset
b. source of financing
c. matching principle
d. financing mix
e. form of financing

21. inventories
22. shareholders and lenders
23. mortgage
24. short-term debt and inventory
25. commercial bank

21. ANS: A PTS: 1
22. ANS: D PTS: 1
23. ANS: E PTS: 1
24. ANS: C PTS: 1
25. ANS: B PTS: 1

Match each term with the correct definition.

a. demassing
b. gross profit
c. profit for the year
d. inventories
e. financing mix

26. belongs to the shareholders
27. removal of management layers
28. revenue less cost of sales
29. proportion of debt versus equity
30. working capital account

26. ANS: C PTS: 1
27. ANS: A PTS: 1
28. ANS: B PTS: 1
29. ANS: E PTS: 1
30. ANS: D PTS: 1

Match each term with the correct definition.

a. statement of income
b. matching principle
c. planned downsizing
d. trade receivables
e. capital asset

31. budgeting technique
32. working capital account
33. operating decision
34. equipment
35. financing

31. ANS: C PTS: 1
32. ANS: D PTS: 1
33. ANS: A PTS: 1
34. ANS: E PTS: 1
35. ANS: B PTS: 1

Match each term with the correct definition.

a. non-current assets
b. liabilities
c. statement of income
d. liquidity
e. stability

36. financial structure
37. investing decisions
38. financing decisions
39. operating decisions
40. working capital

36. ANS: E PTS: 1
37. ANS: A PTS: 1
38. ANS: B PTS: 1
39. ANS: C PTS: 1
40. ANS: D PTS: 1

Match each term with the correct definition.

a. liquidity

b. financing
c. return on revenue
d. non-current assets
e. finance costs

41. efficiency
42. shareholders
43. statement of income
44. statement of financial position
45. working capital management

41. ANS: C PTS: 1
42. ANS: E PTS: 1
43. ANS: B PTS: 1
44. ANS: D PTS: 1
45. ANS: A PTS: 1

Match each term with the correct definition.

a. improvement
b. deterioration
c. ROS
d. gross profit
e. operating income

46. inventory goes from 5X to 4X
47. profit for the year related to revenue
48. collection period: 30 days to 25
49. income statement
50. revenue less cost of sales

46. ANS: B PTS: 1
47. ANS: C PTS: 1
48. ANS: A PTS: 1
49. ANS: E PTS: 1
50. ANS: D PTS: 1

Match each term with the correct definition.

a. corporate culture
b. global accounting
c. transparency
d. Sabarnes-Oxley
e. management wave

51. information
52. quantitative movement
53. financial standards
54. values
55. law

51. ANS: C PTS: 1
52. ANS: E PTS: 1
53. ANS: B PTS: 1
54. ANS: A PTS: 1

55. ANS: D PTS: 1

PROBLEM

1. An individual intends to invest $100,000 in a new business. The financial projections show that during the first year of operations the business will generate $12,500 in profit for the year. Calculate the expected return on assets?

   The return on assets is _________________ .

   ANS:
   ROA is 12.5%

Profit for the year	$ 12,500 ÷
Total assets	$100,000

   PTS: 1

2. With the following information, calculate the company's average daily sales:
   Revenue is $250,000
   Cost of sales is $230,000
   Trade receivables is $100,000

   The average daily sales is _________________ .

   ANS:

Average daily sales is	$684.93
Revenue	$ 250,000 ÷
Number of days	365

   PTS: 1

3. A company invested $100,000 in a business. During the first year of operations the business generated $25,000 in profit before taxes. The company's income tax rate is 25%. Calculate the company's return on investment.

   The company's return on investment is _________________ .

   ANS:
   ROA is 18.75%.

Profit before taxes	$ 25,000	
Income tax expense	$ 6,250	($25,000 x 25%)
Profit for the year	$ 18,750 ÷	
Investment	$ 100,000	

   PTS: 1

4. With the following information, calculate the company's weighted cost of capital. Assume that all costs are on an after-tax basis.

		Cost
Mortgage	$400,000	6.0%
Bond	300,000	4.0%
Capital shares	300,000	10.0%

The weighted average cost of capital is _________________ .

ANS:
The weighted average cost of capital is 6.6%..

	Proportion	Cost	Weighted	Cost
Mortgage	$400,000	0.40	6.0%	2.4%
Bond	300,000	0.30	4.0%	1.2%
Capital shares	300,000	0.40	10.0%	3.0%
		1.00		6.6%

PTS: 1

5. A company wants to reinvest 60% of their $60,000 profit for the year in their business and use the rest to pay down the principal on its loan and dividends to their common shareholders. The company expects to invest 70% of their retained earnings in non-current assets and 30% in working capital. The company's revenue is $600,000.

On the basis of this information, calculate how much the managers would keep in their business for growth reasons and how much would be used to pay off their loan and the amount that would be invested in non-current assets and in working capital.

Retained earnings: $______________ Loan and dividends: $______________
Non-current assets: $______________ Working capital: $______________

ANS:
60% of the $60,000 profit for the year is $36,000 allocated for retained earnings
40% of the $60,000 profit for the year is $24,000 allocated to pay the loan and dividends

70% of the $36,000 retained earnings or $25,200 will be spent on non-current assets
30% of the $36,000 retained earnings or $10,800 will be spent on working capital

PTS: 1

Statement of Income

Revenue	$ 3,000,000
Cost of sales	(2,000,000)
Gross profit	1,000,000
Operating expenses	(650,000)
Profit before taxes	350,000
Income tax expense	(150,000)
Profit for the year	$ 200,000

Statement of Financial Position

Non-current assets	$ 1,200,000	Equity		$ 800,000
Inventories	400,000	Long-term borrowings	800,000	
Trade receivable	380,000	Trade and other payables		100,000
Cash	$ 20,000	Short-term borrowings	$ 300,000	

Short-term borrowings interest rate	8 % (before tax)
Long-term borrowings interest rate	6 % (before tax)
Shareholders expected return on investment	12%

6. The company's current assets are ________________________ .

ANS:
Current assets are $ 800,000.

Inventories	$ 400,000
Trade receivable s	380,000
Cash	20,000
Current assets	$ 800,000

PTS: 1

7. The company's current liabilities are ________________________ .

ANS:
Current liabilities are $ 400,000.

Short-term borrowings	$ 300,000
Trade and other payable s	100,000
Current liabilities	$ 400,000

PTS: 1

8. The company's net working capital is ________________________ .

ANS:
Net working capital is $ 400,000.

Current assets	$ 800,000
Current liabilities	400,000
Net working capital	$ 400,000

PTS: 1

9. The company's total assets is ________________________ .

ANS:
Total assets are $ 2,000,000.

Non-current assets	$ 1,200,000
Inventories	400,000
Trade receivable s	380,000
Cash	20,000
Total assets	$ 2,000,000

PTS: 1

10. The company's total liabilities is ________________________ .

ANS:
Total liabilities are $ 1,200,000.

Long-term borrowings	$ 800,000

Short-term borrowings	300,000
Trade and other payables	100,000
Total liabilities	$ 1,200,000

PTS: 1

11. The company's total equity and liabilities is ________________________ .

ANS:
Total equity and liabilities is $ 2,000,000.

Equity	$ 800,000
Total liabilities	1,200,000
Total liabilities and equity	$ 2,000,000

PTS: 1

12. The company's return on assets is ________________________ .

ANS:
Return on assets is 10%.

Profit for the year	$ 200,000 ÷
Total assets	$ 2,000,000

PTS: 1

13. The company's return on revenue is ________________________ .

ANS:
Return on revenue is 6.7%.

Profit for the year	$ 200,000 ÷
Revenue	$ 3,000,000

PTS: 1

14. The company's after tax cost of financing is ________________________ .

ANS:
The after tax cost of financing is 7.21 %.

Sources		Proportion		After-tax cost		Weighted cost of financing
Equity	$ 800,000	42.1	x	12.0 %	=	5.05 %
Long-term borrowings	800,000	42.1	x	3.4 %	=	1.43 %
Short-term borrowings	300,000	15.8	x	4.6 %	=	.73 %
Total	$ 1,900,000	100.0				7.21 %

The company's income tax rate is 42.8% ($ 150,000 ÷ $ 350,000).

After tax cost for the short-term borrowings	4.6 % (8 % x 57.2)
After tax cost for the long-term borrowings	3.4 % (6 % x 57.2)
Shareholders expected return	12.0 %

PTS: 1

15. If the statement of income would show an depreciation/amortization amount of $20,000, what would be the cash generated by the company?

The cash flow would be ______________________________ .

ANS:
The cash would be $ 220,000.

Profit for the year	$ 200,000
Depreciation/amortization	20,000
Cash flow	$ 220,000

PTS: 1

16. If the company's accounts receivable is lowered to $300,000, how much cash will it generate?

The additional cash would be ________________________ .

ANS:
The additional cash flow from trade receivables would be $ 80,000.

The existing level of trade receivables		$ 380,000
The new level of trade receivable	300,000	
Additional cash flow		$ 80,000

PTS: 1

17. If the company improves its inventory turnover to $350,000, how much cash will it generate?

The additional cash would be ________________________ .

ANS:
The additional cash flow from inventories would be $ 50,000.

The existing level of inventories	$ 400,000	
The new level of inventories		350,000
Additional cash flow		$ 50,000

PTS: 1

18. If the company's return on revenue is improved to 8.0%, how much profit for the year would be generated?

The additional net income would be ________________________ .

ANS:

The additional profit for the year would be $ 40,000.

Existing profit for the year is	$ 200,000	
Profit for the year would be	240,000	($3,000,000 x 8.0%)
Additional profit for the year	$ 40,000	

PTS: 1

19. By using the information contained in exercises 6.11, 6.12, 6.13 and 6.14, how much cash would the company generate?

The additional cash would be ______________________________.

ANS:
The incremental cash would be $ 190,000.

From depreciation/amortization		$ 20,000
From trade receivables		$ 80,000
From inventories	50,000	
From additional profit for the year	40,000	
Additional cash flow		$190,000

PTS: 1

20. By using the information contained in exercise 6.14, what would the company's new return on assets?

The new return on assets would be ________________________ .

ANS:
The new return on assets would be 12.0 %.

New profit for the year level	$ 240,000 ÷
Total assets	2,000,000

PTS: 1

21. The company's before tax cost of financing is ________________________ .

ANS:
The before tax cost of financing is 8.84 %.

Sources financing		Proportion		Before-tax cost		Weighted cost of
Equity	$ 800,000	42.1	x	12.0 %	=	5.05 %
Long-term borrowings	800,000	42.1	x	6.0 %	=	2.53 %
Short-term borrowings	300,000	15.8	x	8.0 %	=	1.26%
Total	$ 1,900,000	100.0				8.84 %

PTS: 1

Statement of Income for the year 2010

Revenue		$ 200,000
Cost of sales		
Depreciation/amortization	(20,000)	
Other costs	(140,000)	
Total cost of sales		(160,000)
Gross profit		40,000
Operating expenses		(20,000)
Profit before taxes		20,000
Income tax expense		(10,000)
Profit for the year		$ 10,000

Statement of Financial Position Accounts

	2009	2010
Mortgage	$200,000	$180,000
Bonds	300,000	350,000
Common shares	150,000	175,000
Preferred shares	70,000	75,000
Non-current assets	$500,000	$610,000

22. Cash flow for operating activities is ________________________.

ANS:
Cash flow for operating activities is $10,000.

The make-up of this cash inflow is as follows:

Profit for the year	$10,000
Depreciation/amortization	20,000
Adjustments in working capital accounts	(20,000)
Total cash flow from operating activities	$10,000

PTS: 1

23. Cash flow for financing activities is ________________________.

ANS:
Cash flow for financing activities is $100,000

The make-up of this cash inflow is as follows:

	2009	2010	Change
Mortgage	$200,000	$180,000	$ 20,000
Bonds	300,000	350,000	50,000
Common shares	150,000	175,000	25,000
Preferred shares	70,000	75,000	5,000
Total cash flow for financing activities			$ 100,000

PTS: 1

24. Cash flow for investing activities is________________________.

ANS:
Cash outflow for investing activities is $100,000.

Non-current assets	$500,000	$610,000	($110,000)

PTS: 1

25. Net cash flow for these three activities is ________________________,

ANS:
Cash flow for the three activities is zero.

Cash flow from operating activities	$ 10,000
Cash flow from financing activities	100,000
Cash flow for investing activities	($110,000)

PTS: 1