

MONTGOMERY COLLEGE  
 Department of Business and Economics  
 Rockville Campus

**AC 202 REVIEW 2 (CHAPTERS 12, 18, 19, Pricing)**

**I. TRUE/FALSE**

T	F		
		1.	For external reporting, a company must prepare either an income statement or a statement of cash flows, but <b>not</b> both.
		2.	Operating activities include the cash effects of transactions that create revenues and expenses.
		3.	The activity from the balance sheet to be presented in the financing activities section of the statement of cash flows is based on an analysis of stockholders' equity only.
		4.	The statement of cash flows explains the difference between net income, as shown on the income statement, and the net cash flows generated from operations.
		5.	In preparing a statement of cash flows, the issuance of debt should be reported separately from the retirement of debt.
		6.	Non-cash investing and financing transactions, such as the exchange of common stock to purchase assets, represent significant investing and financing activities and are reflected either in a schedule separate from the statement of cash flows or in a separate note to the financial statements.
		7.	The sale of land for cash would be classified as a cash inflow from an investing activity.
		8.	The receipt of dividends from long-term investments in stock is classified as a cash inflow from investing activities.
		9.	A loss on sale of equipment is added to net income in determining cash provided by operations under the indirect method.
		10.	Using the indirect method, an increase in accounts receivable during a period is deducted from net income in calculating cash provided by operations.
		11.	Using the indirect method, an increase in accounts payable during a period is deducted from net income in calculating cash provided by operations.
		12.	In preparing a statement of cash flows, an increase in the common stock and treasury stock accounts during a period would be an investing activity.
		13.	As an adjustment to operating expenses per the income statement, an increase in accrued liabilities would be added to operating expenses to determine cash payments for operating expenses.
		14.	Free cash flow is cash from operations less dividends.
		15.	The cash basis measure of liquidity is the cash debt coverage ratio.
		16.	Fixed cost per unit remains constant at various levels of activity.
		17.	A variable cost remains constant per unit, though in total increases as activity levels increase.
		18.	If the activity level decreases, fixed costs per unit will decrease.
		19.	For CVP analysis, variable costs are assumed to have a linear relationship within the relevant range of activity.
		20.	A mixed cost contains both variable and fixed cost elements.
		21.	If you subtract total costs at the highest level from total costs at the lowest level of activity, the difference is the total fixed cost at that activity level.
		22.	An assumption of CVP analysis is that all costs can be classified as either variable or fixed.
		23.	In CVP analysis, the term 'cost' includes only manufacturing costs.
		24.	The contribution margin per unit is the amount that each unit sold contributes towards covering fixed and variable costs.
		25.	The contribution margin ratio is calculated by dividing the unit contribution margin by the unit sales price.
		26.	Contribution margin equals the total variable costs plus total fixed costs at the break-even point.

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		27. The margin of safety is the difference between sales at break-even and sales at a determined activity level.
		28. A CVP income statement shows contribution margin and gross profit.
		29. A CVP income statement classifies costs into two sections based on behavior.
		30. In full or absorption costing, all manufacturing costs are charged to the product.
		31. Variable costing is the approach used for external reporting under generally accepted accounting principles.
		32. Fixed manufacturing costs are <b>not</b> charged to the product under variable costing.
		33. The difference between absorption costing and variable costing is the treatment of fixed manufacturing overhead.
		34. Fixed manufacturing overhead is a period cost under absorption costing.
		35. When units produced exceed units sold, income under absorption costing is higher than income under variable costing.
		36. When absorption costing is used, management may be tempted to overproduce in a given period in order to increase net income.
		37. The use of absorption costing facilitates cost-volume-profit analysis.
		38. Sales mix is a measure of the percentage increase in sales from period to period.
		39. Sales mix is not important to managers when different products have substantially different contribution margins.
		40. If Conan Corporation sells two products with a sales mix of 75%-25%, and the respective contribution margins are \$100 and \$300, then weighted-average unit contribution margin is \$150.
		41. The breakeven point in dollars is variable costs divided by the weighted-average contribution margin ratio.
		42. Cost structure refers to the relative proportion of fixed versus variable costs that a company incurs.
		43. Operating leverage refers to the extent to which a company's net income reacts to a given change in fixed costs.
		44. If O'Brien Company has a margin of safety ratio of .60, it could sustain a 60 percent decline in sales before it would be operating at a loss.
		45. The difference between the target price and the desired profit is the target cost of the product.
		46. In a competitive environment, the company must set a target cost and a target selling price.
		47. The cost-plus pricing approach establishes a cost base and adds a markup to this base to determine a target selling price.
		48. Sales volume plays a large role in determining per unit costs in the cost-plus pricing approach.
		49. The material loading charge is expressed as a percentage of the total estimated costs of materials for the year.
		50. Using the negotiated transfer pricing approach, a minimum transfer price is established by the selling division.
		51. A problem with a cost-based transfer price is that it does <b>not</b> provide adequate incentive for the selling division to control costs.
		52. The market-based transfer price approach produces a higher total contribution margin to the company than the cost-based approach.
		53. A negotiated transfer price should be used when an outside market for the goods does <b>not</b> exist.
		54. The first step in the absorption cost approach is to compute the markup percentage used in setting the target selling price.
		55. Because absorption cost data already exists in general ledger accounts, it is cost effective to use it for pricing.

II. The financial statements of Sosa Importing Corporation provide the following information for the current year:

	12-31-07	01-01-07
Accounts Receivable	\$195,000	\$216,000
Merchandise Inventory	243,000	228,000
Short-term Prepayments	6,000	4,500
Accounts Payable (Exclusively for Merchandise Purchases)	171,000	165,000
Accrued Operating Expenses Payable	19,500	28,200
Accrued Income Taxes Payable	6,600	10,500
Net Sales	795,000	
Cost of Goods Sold	459,000	
Operating Expenses (Inclusive of \$36,000 of Depreciation)	294,000	
Income Tax Expense	33,000	

Using this information, compute the following for 2007:

(a) Cash receipts from customers \$ \_\_\_\_\_

(b) Cash payments to suppliers \$ \_\_\_\_\_

(c) Cash payments for operating expenses \$ \_\_\_\_\_

(d) Cash payments for income taxes \$ \_\_\_\_\_

(e) Prepare the operating activities section of a Statement of Cash Flows for Sosa Importing Corporation for 2007, using the direct method. Use the form below.


III. The financial statements of Montana Company appear below:

**MONTANA COMPANY**  
**Comparative Balance Sheet**  
**December 31**

<u>Assets</u>	<u>2007</u>	<u>2006</u>
Cash .....	\$ 25,000	\$ 40,000
Marketable securities .....	15,000	60,000
Accounts receivable (net) .....	50,000	30,000
Inventory .....	50,000	70,000
Property, plant and equipment (net) .....	<u>260,000</u>	<u>300,000</u>
Total assets .....	<u>\$400,000</u>	<u>\$500,000</u>
 <u>Liabilities and stockholders' equity</u>		
Accounts payable .....	\$ 20,000	\$ 30,000
Short-term notes payable .....	30,000	90,000
Bonds payable .....	90,000	160,000
Common stock .....	150,000	150,000
Retained earnings .....	<u>110,000</u>	<u>70,000</u>
Total liabilities and stockholders' equity .....	<u>\$400,000</u>	<u>\$500,000</u>

**MONTANA COMPANY**  
**Income Statement**  
**For the Year Ended December 31, 2007**

Net sales .....	\$400,000
Cost of goods sold .....	<u>240,000</u>
Gross profit .....	160,000
Expenses	
Interest expense .....	\$18,000
Selling expenses .....	28,000
Administrative expenses .....	<u>24,000</u>
Total expenses .....	<u>70,000</u>
Income before income taxes .....	90,000
Income tax expense .....	<u>27,000</u>
Net income .....	<u>\$ 63,000</u>

Additional information:

- a. Cash dividends of \$23,000 were declared and paid in 2007.
- b. Net cash flow from operating activities was \$78,000.

**INSTRUCTIONS:**

Using the financial statements and additional information above, prepare a Statement of Cash Flows for Montana Company for 2007, using the indirect method. Use the form on page 5.



**IV. Identifying Cash Flow Statement Items**

For each of the following items, identify the section of the statement of cash flows where it would appear. Use **(O)** for operating activities, **(I)** for investing activities, **(F)** for financing activities, **(NCIF)** for significant non-cash investing and financing activities, and **(N/A)** if the item does not appear anywhere on the statement of cash flows. Assume the statement is prepared using the direct method.

	a.	Purchase of treasury stock
	b.	Sale of land for cash
	c.	Depreciation of machinery
	d.	Conversion of bonds into common stock
	e.	Net income
	f.	Payment of cash dividends
	g.	Interest expense
	h.	Loss on sale of equipment
	i.	Issuance of preferred stock for cash
	j.	Purchase of stock as a long-term investment
	k.	Distribution of a 10% stock dividend
	l.	Payment of income taxes
	m.	Interest received on notes receivable
	n.	Collection of accounts receivable

**V.** Presented below are variable costing income statements for Gina Company and Elvira Corporation. They are in the same industry, with the same net incomes, but different cost structures.

	<b>GINA COMPANY</b>	<b>ELVIRA CORPORATION</b>
Sales	\$150,000	\$150,000
Variable Costs	60,000	15,000
Contribution Margin	90,000	135,000
Fixed Costs	50,000	95,000
Net Income	\$ 40,000	\$ 40,000

**INSTRUCTIONS:**

Compute the break-even point in dollars for each company and comment on your findings.





