

Chapter 02 Test Bank - Static KEY

<https://selldocx.com/products/test-bank-corporate-finance-11e-ross>

1. Which one of these equations is an accurate expression of the balance sheet?

- A. Assets $\equiv$ Liabilities – Stockholders' equity
- B. Stockholders' equity $\equiv$ Assets + Liabilities
- C. Liabilities $\equiv$ Stockholders' equity – Assets
- D. Assets $\equiv$ Stockholders' equity – Liabilities
- E. Stockholders' equity $\equiv$ Assets – Liabilities**

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Balance sheet

2. Which one of these accounts is classified as a current asset on the balance sheet?

- A. intangible asset
- B. accounts payable
- C. preferred stock
- D. inventory**
- E. net plant and equipment

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Balance sheet

3. On a balance sheet, deferred taxes are classified as:

- A. stockholders' equity.
- B. a current asset.
- C. a long-term liability.**
- D. a fixed asset.
- E. a current liability.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Balance sheet

4. Net working capital is defined as:

- A. current assets plus fixed assets.
- B. current assets plus stockholders' equity.
- C. fixed assets minus long-term liabilities.
- D. total assets minus total liabilities.
- E. current assets minus current liabilities.**

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Net working capital

5. An asset that can be quickly converted into cash without significant loss in value is referred to as being:

- A. marketable.
- B. tangible.**

- C. intangible.
- D. liquid.
- E. fixed.

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Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Liquidity

6. The financial statement summarizing a firm's accounting performance over a period of time is the:

- A. income statement.
- B. balance sheet.
- C. statement of cash flows.
- D. tax reconciliation statement.
- E. statement of equity.

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Blooms: Remember
Difficulty: 1 Basic
Section: 2.2 The Income Statement
Topic: Income statement

7. Noncash items refer to:

- A. the credit sales of a firm.
- B. the accounts payable of a firm.
- C. the costs incurred for the purchase of intangible fixed assets.
- D. expenses charged against revenues that do not directly affect cash flow.
- E. all accounts on the balance sheet other than cash on hand.

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.2 The Income Statement
Topic: Noncash items

8. For a firm with long-term debt, net income is equal to:

- A. Pretax income - Interest expense - Taxes.
- B. EBIT - Taxes.
- C. Taxes + Addition to retained earnings.
- D. Pretax income $\times$ (1 - Marginal tax rate).
- E. Dividends + Addition to retained earnings.

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Blooms: Apply
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Income statement

9. Which term defines the tax rate that applies to the next dollar of taxable income earned?

- A. deductible
- B. residual
- C. total
- D. average
- E. marginal

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic

10. U.S. corporate taxes switch to a constant flat-rate tax once the average tax rate reaches:

- A. 32 percent.
- B. 33 percent.
- C. 28 percent.
- D. 40 percent.
- E. 35 percent.**

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.3 Taxes
Topic: Taxes

11. The cash flow resulting from a firm's ongoing, normal business activities is referred to as the:

- A. operating cash flow.**
- B. net capital spending.
- C. additions to net working capital.
- D. cash flow to retained earnings.
- E. cash flow to investors.

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Blooms: Remember
Difficulty: 1 Basic
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow

12. Capital spending is equal to:

- A. ending net fixed assets minus beginning net fixed assets.
- B. ending net fixed assets minus beginning net fixed assets plus depreciation.**
- C. ending total assets minus beginning total assets.
- D. ending total assets minus beginning total assets minus depreciation.
- E. beginning total assets plus asset purchases minus asset sales.

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending

13. Operating cash flow is defined as:

- A. Pretax income - Taxes.
- B. Net income - Dividends.
- C. EBIT + Depreciation - Taxes.**
- D. Pretax income + Depreciation.
- E. Cash flow to investors + Taxes.

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Blooms: Remember
Difficulty: 1 Basic
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow

14. In the accounting statement of cash flows, which one of these is calculated by adding back noncash expenses to net

income and adjusting for changes in current assets and liabilities?

- A. cash flow from investing activities
- B. cash flow from financing activities
- C. net working capital
- D.** cash flow from operating activities
- E. cash flow to investors

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows

15. Which one of these terms refers to the firm's interest payments less any net new borrowing?

- A. operating cash flow
- B. capital spending
- C. net working capital
- D. cash flow to stockholders
- E.** cash flow to creditors

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Blooms: Remember
Difficulty: 1 Basic
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors

16. A firm's dividend payments less any net new equity raised is referred to as the firm's:

- A. operating cash flow.
- B. capital spending.
- C. net working capital.
- D. cash flow from creditors.
- E.** cash flow to stockholders.

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders

17. Earnings per share will increase when:

- A.** depreciation decreases.
- B. the number of shares outstanding increase.
- C. operating income decreases.
- D. dividends per share decrease.
- E. the average tax rate increases.

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Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Per-share valuations

18. Assuming the number of shares outstanding remains constant, an increase in dividends per share will reduce the:

- A. earnings per share.
- B.** addition to retained earnings.
- C. net income.
- D. cash flow to stockholders.
- E. cash flow from assets.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Per-share valuations

19. Which one of these is a non-cash item?

- A.** depreciation
- B. interest expense
- C. current taxes
- D. dividends
- E. selling expenses

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.2 The Income Statement
Topic: Noncash items

20. Which one of the following is a current liability?

- A. amount due to a supplier in 18 months
- B.** debt payable to a mortgage company in nine months
- C. estimated taxes just paid
- D. loan payment due in 13 months
- E. amount due from a customer in 30 days

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1
The Balance Sheet Topic: Balance sheet

21. An increase in total assets:

- A. means that net working capital is also increasing.
- B. requires an investment in fixed assets.
- C. means that stockholders' equity must also increase.
- D.** must be offset by an equal increase in liabilities and stockholders' equity.
- E. can only occur when a firm has positive net income.

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1
The Balance Sheet
Topic: Balance sheet

22. Which one of the following assets is generally the most liquid?

- A. inventory
- B. buildings
- C. accounts receivable
- D. equipment
- E. patents

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Liquidity

23. Which one of the following statements concerning liquidity is correct?

- A. If you sold an asset today, it was a liquid asset.
- B. If you can sell an asset next year at a price equal to its actual value, the asset is highly liquid.
- C. Trademarks and patents are highly liquid.
- D. The less liquidity a firm has, the lower the probability the firm will encounter financial difficulties.
- E. Balance sheet accounts are listed in order of decreasing liquidity.

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Liquidity

24. Liquidity is:

- A. a measure of the use of debt in a firm's capital structure.
- B. equal to current assets minus current liabilities.
- C. equal to the market value of a firm's total assets minus its total liabilities.
- D. valuable to a firm even though liquid assets tend to be less profitable to own.
- E. generally associated with intangible assets.

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Liquidity

25. Which one of the following accounts is included in stockholders' equity?

- A. long-term debt
- B. deferred taxes
- C. plant and equipment
- D. accumulated retained earnings
- E. intangible assets

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Balance sheet

26. Book value:

- A. is equivalent to market value for firms with fixed assets.
- B. is based on historical cost.
- C. generally tends to exceed market value when fixed assets are included.
- D. is more of a financial than an accounting valuation.
- E. is adjusted to market value whenever the market value exceeds the stated book value.

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Accessibility: Keyboard Navigation
Blooms: Understand

27. If you sell an asset, you are most apt to receive which value for that asset?

- A. market value
- B. original cost minus accumulated depreciation
- C. historical value
- D. book value
- E. carrying value

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.1 The Balance Sheet
Topic: Market and book values

28. As seen on an income statement:

- A. interest is deducted from income and increases the total taxes incurred.
- B. the tax rate is applied to the earnings before interest and taxes when the firm has both depreciation and interest expenses.
- C. depreciation is shown as an expense but does not affect the tax expense.
- D. depreciation reduces both the pretax income and the net income.
- E. interest expense is added to earnings before interest and taxes to compute pretax income.

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Income statement

29. All else held constant, the earnings per share will:

- A. decrease as net income increases.
- B. decrease as the number of shares outstanding increase.
- C. decrease as the total revenue of the firm increases.
- D. increase as the tax rate increases.
- E. decrease as the costs decrease.

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Per-share valuations

30. Which one of these statements is correct?

- A. Pretax income is equal to net income minus taxes.
- B. The addition to retained earnings is equal to net income plus dividends.
- C. Operating income is equal to operating revenue minus cost of goods sold.
- D. Only current taxes are included in the tax expense.
- E. Earnings per share can be negative but dividends per share cannot.

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Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Income statement

31. Earnings per share:

- A. will increase if net income increases and number of shares outstanding decreases.
- B. will increase if net income decreases and number of shares outstanding increases.
- C. is defined as the addition to retained earnings divided by the number of shares outstanding.
- D. is the total amount of dividends paid per year on a per share basis.
- E. must increase at the same rate as the total operating revenue.

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 Accessibility: Keyboard Navigation
 Blooms: Understand
 Difficulty: 2 Intermediate
 Section: 2.2 The Income Statement
 Topic: Per-share valuations

32. According to the Generally Accepted Accounting Principles, costs are:

- A. recorded as incurred.
- B. recorded when paid.
- C. matched with revenues.
- D. matched with production levels.
- E. expensed as management desires.

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 Blooms: Understand
 Difficulty: 2 Intermediate
 Section: 2.2 The Income Statement
 Topic: Generally Accepted Accounting Principles (GAAP)

33. Depreciation for a profitable firm:

- A. decreases net income by less than \$1 for every \$1 of depreciation expense.
- B. increases the net fixed assets as shown on the balance sheet.
- C. reduces both the net fixed assets and the costs of a firm.
- D. is a non-cash expense which increases the net operating income.
- E. decreases net fixed assets, net income, and operating cash flows.

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 Blooms: Understand
 Difficulty: 2 Intermediate
 Section: 2.2 The Income Statement
 Topic: Income statement

34. When you are making a financial decision, the most relevant tax rate is the ____ rate.

- A. average
- B. fixed
- C. marginal
- D. total
- E. variable

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 Accessibility: Keyboard Navigation
 Blooms: Understand
 Difficulty: 2 Intermediate
 Section: 2.3 Taxes
 Topic: Taxes

35. An increase in which one of the following will cause the operating cash flow to increase for a profitable firm?

- A. depreciation
- B. changes in the amount of net fixed capital
- C. net working capital
- D. taxes
- E. administrative expenses

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 Blooms: Apply
 Difficulty: 2 Intermediate

36. A firm starts its year with a positive net working capital. During the year, the firm acquires more short-term debt than it does short-term assets. This means that:

- A. the ending net working capital will be negative.
- B. both accounts receivable and inventory decreased during the year.
- C. the beginning current assets were less than the beginning current liabilities.
- D. accounts payable increased and inventory decreased during the year.
- E.** the ending net working capital can be positive, negative, or equal to zero.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.4 Net Working Capital
Topic: Net working capital

37. The cash flow to creditors includes the firm's cash:

- A. outflow when payments are paid to suppliers.
- B. outflow when new debt is acquired.
- C.** outflow when interest is paid on outstanding debt.
- D. inflow when accounts payable increases.
- E. Inflow when long-term debt is paid off.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors

38. The cash flow to stockholders must be positive when:

- A. the dividends paid are less than the amount of net new equity raised.
- B. the net sale of common stock exceeds the amount of dividends paid.
- C. no income is distributed but new shares of stock are sold.
- D.** the cash flow from assets is positive and also exceeds the cash flow to creditors.
- E. both the cash flow to assets and the cash flow to creditors are positive.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders

39. Which one of these will increase the book value of the stockholders' equity in a profitable, non-dividend paying firm? Assume no shares of stock are repurchased or sold.

- A. a decrease in the book value of inventory
- B.** an increase in earnings per share
- C. an increase in the market value of the firm's buildings
- D. an increase in the market value of the firm's long-term debt
- E. an increase in non-cash expenses

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Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Market and book values

40. Assets are listed on the balance sheet in order of:

- A. decreasing liquidity.
- B. decreasing size.
- C. increasing size.
- D. market value relative to book value.
- E. increasing liquidity.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Liquidity

41. An increase in treasury stock:

- A. increases the total equity of the firm.
- B. is the result of a firm issuing new shares to stock to the federal government.
- C. increases the number of shares outstanding.
- D. results from a repurchase of outstanding shares of stock.
- E. requires repayment at some point in the future.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Balance sheet

42. The carrying value or book value of assets:

- A. is determined under GAAP and is based on the cost of the asset.
- B. represents the true market value according to GAAP.
- C. is always the best measure of the company's value to an investor.
- D. is always higher than the replacement cost of the assets.
- E. is shown on the firm's income statement.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Generally Accepted Accounting Principles (GAAP)

43. Under generally accepted accounting principles (GAAP), a firm's assets are reported at:

- A. market value.
- B. liquidation value.
- C. market value less accumulated depreciation.
- D. historical cost less accumulated depreciation.
- E. liquidation value less accumulated depreciation.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Generally Accepted Accounting Principles (GAAP)

44. The income statement:

- A. measures performance for one specific day.
- B. ignores any income other than operating revenues.
- C. excludes deferred tax expense.
- D. treats dividends paid as a cash expense.
- E. includes noncash expenses.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand

45. According to generally accepted accounting principles (GAAP), revenue is recognized as income when:

- A. a contract is signed to perform a service or deliver a good.
- B. the transaction is complete and the goods or services are delivered.**
- C. payment is requested.
- D. income taxes are paid on the revenue earned.
- E. managers decide to recognize it.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.2 The Income Statement
Topic: Income statement

46. Cash flow from assets:

- A. equals net income plus non-cash items.
- B. can be positive, negative, or equal to zero.**
- C. equals operating cash flow minus net capital spending.
- D. equals the addition to retained earnings.
- E. equals operating cash flow minus the cash flow to creditors.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets

47. Net capital spending is equal to the:

- A. net change in total assets plus depreciation.
- B. net change in fixed assets plus depreciation.**
- C. net income plus depreciation.
- D. difference between the market and book values of the total assets.
- E. change in total assets.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets

48. Cash flow to stockholders is defined as:

- A. cash dividends paid.
- B. repurchases of equity less new equity sold minus cash dividends paid.
- C. cash flow from financing less cash flow to creditors.
- D. cash dividends paid plus repurchases of equity minus new equity financing.**
- E. cash flow from assets plus cash flow to creditors.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders

49. Free cash flow is:

- A. the money generated from the sale of new shares of stock.
- B. another term for operating cash flow.
- C. the cash generated by decreasing net working capital.

- D. cash that the firm can distribute to creditors and stockholders.
E. the net income of a firm after taxes have been paid.

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.5 Cash Flow of the Firm
Topic: Free cash flow

50. The cash flow of the firm must be equal to:

- A. cash flow to stockholders minus cash flow to creditors.
B. cash flow to creditors minus cash flow to stockholders.
C. cash flow to governments plus cash flow to stockholders.
D. cash flow to stockholders plus cash flow to creditors.
E. the aftertax operating cash flow.

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Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Basic
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets

51. The statement of cash flows consists of the cash flows from:

- A. operations, investing activities, and financing activities.
B. operations, investing activities, and divesting activities.
C. internal activities, external activities, and financing activities.
D. balance sheet accounts only.
E. income statement accounts only.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows

52. One of the reasons why cash flow analysis is popular is because:

- A. cash flows are more subjective than net income.
B. deferred taxes require future cash payment.
C. cash flows are strictly defined by generally accepted accounting principles (GAAP).
D. it is difficult to manipulate, or spin the cash flows.
E. operating cash flows are found on the income statement.

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Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Intermediate
Section: 2.7 Cash Flow Management
Topic: Cash flows

53. A firm has \$820 in inventory, \$3,200 in fixed assets, \$1,210 in accounts receivable, \$890 in accounts payable, and \$360 in cash. What is the amount of the net working capital?

- A. \$4,700
B. \$5,590
C. \$3,600
D. \$2,390
E. \$1,500

AACSB: Analytical Thinking
Accessibility: Keyboard-Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.4 Net Working Capital
Topic: Net working capital

54. Total assets are \$1,450, fixed assets are \$790, long-term debt is \$750, and short-term debt is \$300. What is the amount of current assets?

- A. \$660
- B. \$360
- C. \$300
- D. \$40
- E. \$790

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Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Balance sheet

55. Brad's Company has equipment with a book value of \$500 that could be sold today at a 50 percent discount. Its inventory is valued at \$450 and could be sold to a competitor for that amount. The firm has \$100 in cash and customers owe the firm \$250, all of which is collectible. What is the current market value of the firm's assets?

- A. \$100
- B. \$550
- C. \$1,050
- D. \$1,300
- E. \$600

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Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Market and book values

56. Martha's Enterprises spent \$4,100 to purchase equipment three years ago. This equipment is currently valued at \$2,700 on today's balance sheet but could actually be sold for \$3,200. Net working capital is \$400 and long-term debt is \$2,300. Assuming the equipment is the firm's only fixed asset, what is the book value of shareholders' equity?

- A. \$1,300
- B. \$800
- C. \$1,600
- D. \$1,900
- E. \$2,200

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Market and book values

57. Mart's Boutique has sales of \$820,000 and costs of \$540,000. Interest expense is \$36,000 and depreciation is \$59,000. The tax rate is 35 percent. What is the net income?

- A. \$158,600
- B. \$120,250
- C. \$105,000
- D. \$179,250
- E. \$99,600

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Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.2 The Income Statement
Topic: Income statement

58. Given the tax rates as shown, what is the average tax rate for a firm with taxable income of \$218,700?

Taxable Income	Tax Rate (%)
\$0 – 50,000	15
50,001 –75,000	25
75,001 –100,000	34
100,001 –335,000	39

- A. 32.09%
- B. 33.88%
- C. 31.34%**
- D. 34.64%
- E. 39.00%

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 Accessibility: Keyboard Navigation
 Blooms: Apply
 Difficulty: 2 Intermediate
 Section: 2.3 Taxes
 Topic: Taxes

59. The tax rates are as shown. Your firm currently has taxable income of \$83,200. How much additional tax will you owe if you increase your taxable income by \$24,600?

Taxable Income	Tax Rate (%)
\$0 – 50,000	15
50,001 –75,000	25
75,001 –100,000	34
100,001 –335,000	39

- A. \$8,364
- B. \$9,014
- C. \$9,594
- D. \$8,754**
- E. \$8,174

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 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.3 Taxes
 Topic: Taxes

60. Your firm has total sales of \$22,980, costs of \$14,715, and depreciation of \$6,045. The tax rate is 34 percent. There are no interest expenses or other income. What is the operating cash flow?

- A. \$1,465.20
- B. \$2,410.80
- C. \$8,340.00
- D. \$7,510.20**
- E. \$9,019.80

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 Accessibility: Keyboard Navigation
 Blooms: Analyze

61. Awnings Incorporated has beginning net fixed assets of \$234,100 and ending net fixed assets of \$243,600. Assets valued at \$42,500 were sold during the year. Depreciation was \$62,500. What is the amount of net capital spending?

- A. \$42,500
- B. \$9,500
- C. \$72,000**
- D. \$53,000
- E. \$29,500

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending

62. At the beginning of the year, a firm has current assets of \$16,200 and current liabilities of \$13,280. At the end of the year, the current assets are \$14,800 and the current liabilities are \$14,210. What is the change in net working capital?

- A. \$470
- B. \$50
- C. \$470
- D. \$2,330**
- E. \$2,330

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Intermediate
Section: 2.4 Net Working Capital
Topic: Net working capital

63. At the beginning of the year, long-term debt of a firm is \$2,400 and total debt is \$3,150. At the end of the year, long-term debt is \$2,800 and total debt is \$4,370. The interest paid is \$40. What is the amount of the cash flow to creditors?

- A. \$440
- B. ?\$40
- C. \$1,260
- D. \$1,180
- E. ?\$360**

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditor

64. Pete's Boats has beginning long-term debt of \$840 and ending long-term debt of \$790. The beginning and ending total debt balances are \$1,220 and \$1,360, respectively. The interest paid is \$30. What is the amount of the cash flow to creditors?

- A. \$80**
- B. -\$110
- C. \$110
- D. \$20
- E. -\$80

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors

65. Peggy Grey's Cookies had net income of \$8,110. The firm paid out 30 percent of the net income to its shareholders as

dividends. During the year, the company repurchased \$500 worth of common stock. What is the cash flow to stockholders?

- A.** \$2,933
- B. \$5,177
- C. \$1,933
- D. \$2,433
- E. \$2,967

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders

66. Thompson's Jet Skis has operating cash flow of \$11,618. Depreciation is \$2,345 and interest paid is \$395. A net total of \$485 was paid on long-term debt. The firm spent \$6,180 on fixed assets and decreased net working capital by \$420. What is the cash flow of the firm?

- A.** \$5,858
- B. \$8,203
- C. \$9,228
- D. \$5,018
- E. \$7,363

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets

67.

Woodlands Inc.
2015 Income Statement
(\$ in millions)

Total operating revenues	\$3,806
Cost of goods sold	2,315
Selling, general, and administrative expenses	546
Depreciation	311
Earnings before interest and taxes (EBIT)	\$634
Interest expense	170
Pretax income	\$464
Taxes	162
Net income	\$302
Dividends	75

Woodlands Inc.
Balance Sheet
(\$ in millions)

Assets	2015	2014	Liabilities and Stockholders' Equity	2015	2014
Cash and equivalents	\$ 503	\$ 227	Accounts payable	\$ 686	\$ 613
Accounts receivable	418	522	Long-term debt	1,300	1,350
Inventory	1,239	1,187	Common stock	1,500	1,500
Net property & equipment	2,290	2,264	Capital surplus	745	745
Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the change in the net working capital from 2014 to 2015?

- A. \$2,343 million
- B. \$1,035 million
- C. \$151 million**
- D. \$305 million
- E. \$674 million

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.4 Net Working Capital
Topic: Net working capital

Woodlands Inc.
2015 Income Statement
(\$ in millions)

Total operating revenues	\$3,806
Cost of goods sold	2,315
Selling, general, and administrative expenses	546
Depreciation	311
Earnings before interest and taxes (EBIT)	\$634
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Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the amount of the non-cash items for 2015?

- A. \$481 million
- B. \$0
- C. \$227 million
- D. \$311 million
- E. \$473 million

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze

69.

Woodlands Inc.
2015 Income Statement
(\$ in millions)

Total operating revenues	\$3,806
Cost of goods sold	2,315
Selling, general, and administrative expenses	546
Depreciation	311
Earnings before interest and taxes (EBIT)	\$634
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(\$ in millions)

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Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the amount of the net capital spending for 2015?

- A. -\$29 million
- B. \$26 million

- C. \$337 million
D. \$1,66 million
E. \$285 million

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending

70.

Woodlands Inc.
2015 Income Statement
(\$ in millions)

Total operating revenues	\$3,806
Cost of goods sold	2,315
Selling, general, and administrative expenses	546
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Earnings before interest and taxes (EBIT)	\$634
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(\$ in millions)

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Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the operating cash flow for 2015?

- A. \$485 million
- B. \$1,030 million
- C. \$867 million
- D.** \$783 million
- E. \$451 million

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow

71.

Woodlands Inc.
2015 Income Statement
(\$ in millions)

Total operating revenues	\$3,806
Cost of goods sold	2,315
Selling, general, and administrative expenses	546
Depreciation	311
Earnings before interest and taxes (EBIT)	\$634
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Balance Sheet
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Net property & equipment	2,290	2,264	Capital surplus	745	745
Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the cash flow of the firm for 2015?

- A. \$295 million
- B. \$485 million
- C. \$1,340 million
- D. \$590 million
- E. \$310 million

AACSB: Analytical Thinking

72.

Woodlands Inc.
 2015 Income Statement
 (\$ in millions)

Total operating revenues	\$3,806
Cost of goods sold	2,315
Selling, general, and administrative expenses	546
Depreciation	311
Earnings before interest and taxes (EBIT)	\$634
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 Balance Sheet
 (\$ in millions)

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Net property & equipment	2,290	2,264	Capital surplus	745	745
Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the cash flow to stockholders for 2015?

- A. -\$152 million

- B. -\$25 million
- C. \$0
- D. \$25 million
- E. \$75 million

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders

Woodlands Inc.
2015 Income Statement
(\$ in millions)

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Balance Sheet
(\$ in millions)

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Net property & equipment	2,290	2,264	Capital surplus	745	745
Intangible assets	360	360	Retained earnings	579	352
Total assets	\$4,810	\$4,560	Total liabilities & stockholders' equity	\$4,810	\$4,560

What is the cash flow to creditors for 2015?

- A. -\$120 million
- B. -\$50 million
- C. \$120 million
- D. \$220 million**
- E. \$170 million

74.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is the net working capital for 2015?

- A. \$11,45
- B. \$12,240
- C. \$4,955
- D. \$9,915
- E. \$10,005

75.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is the addition to retained earnings for 2015?

- A. \$4,030
- B. \$4,630
- C. \$3,700
- D. \$4,900
- E. \$5,230

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.2 The Income Statement
 Topic: Income statement

76.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is net capital spending for 2015?

- A. -\$850
- B. \$1,759
- C. \$311
- D. \$2,057
- E. \$3,459

77.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is the operating cash flow for 2015?

- A. \$6,460
- B. \$9,069**
- C. \$10,325
- D. \$3,753
- E. \$12,408

78.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is the cash flow of the firm for 2015?

- A. \$885
- B. \$8,042
- C. \$7,297
- D. \$6,425**
- E. \$5,517

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.5 Cash Flow of the Firm
 Topic: Cash flow from assets

79.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is net new borrowing for 2015?

- A. \$6,795
- B. -\$5,565
- C. \$8,025

- D. -\$6,795
E. \$5,565

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors

80.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is the cash flow to creditors for 2015?

- A. \$1,230
B. \$8,025
C. \$9,135
D. -\$5,565
E. -\$2,705

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors

81.

New Town Industries			
Tax rate	35%	2015	2014
Revenues		\$42,629	\$37,911
Cost of goods sold		23,704	24,832
Interest		1,230	1,584
Dividends		1,200	600
Depreciation		2,609	2,814
Administrative expenses		7,040	6,820
Cash		3,671	2,969
Inventory		3,968	4,503
Accounts payable		2,325	3,760
Long-term debt		19,105	25,900
Accounts receivable		4,601	5,318
Common stock		22,600	19,800
Net fixed assets		41,260	42,110

What is the cash flow to stockholders for 2015?

- A. \$1,200
- B. -\$2,800
- C. \$1,520
- D. -\$1,600**
- E. \$2,800

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.5 Cash Flow of the Firm
 Topic: Cash flow to stockholders

82. Last year, Johnson Mills had annual revenue of \$37,800, cost of goods sold of \$23,200, and administrative expenses of \$6,300. The firm paid \$700 in dividends and had a tax rate of 35 percent. The firm added \$2,810 to retained earnings. The firm had no long-term debt. What was the depreciation expense?

- A. \$2,300
- B. \$1,520
- C. \$2,640
- D. \$1,780
- E. \$2,900**

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.2 The Income Statement
 Topic: Income statement

83. Last year, Webster Farms had annual revenue of \$87,200, depreciation of \$11,600, cost of goods sold of \$54,700, and administrative expenses of \$8,300. The firm paid \$3,200 in dividends and paid taxes of \$4,300. What was the operating cash flow?

- A. \$11,500
- B. \$8,300
- C. \$23,100
- D. \$19,900**
- E. \$16,700

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.5 Cash Flow of the Firm

84. Deep Water Mining added \$411 to retained earnings last year on sales of \$24,646. The administrative expenses were \$4,370, depreciation was \$812, dividends paid were \$285, and the interest expense was \$103. What was the cost of goods sold if the firm's tax rate was 35 percent?

- A. \$20,225
- B. \$24,385
- C. \$18,290**
- D. \$14,815
- E. \$21,393

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.2 The Income Statement
 Topic: Income statement

85. Oscar's Dog Treats had a cash flow to creditors of \$2,840, a cash flow to stockholders of \$1,630 last year. The firm spent a net of \$1,420 on fixed assets and reduced net working capital by \$330. What was the operating cash flow?

- A. \$6,190
- B. \$5,560**
- C. \$3,500
- D. \$1,320
- E. \$4,9001

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.5 Cash Flow of the Firm
 Topic: Operating cash flow

86. Define liquidity and explain what a firm would need to do to ensure all of the current assets displayed on its balance sheet are liquid.

Liquid assets are those that can be sold quickly with little or no loss in value. To ensure the current assets are liquid, the firm needs to review its accounts receivable to ensure the accounts are collectible and also review its inventory to ensure it is salable for at least the amount at which it is recorded.

AACSB: Reflective Thinking
 Blooms: Apply
 Difficulty: 2 Intermediate
 Section: 2.1 The Balance Sheet
 Topic: Balance sheet

87. Why is interest expense excluded from the operating cash flow calculation?

Operating cash flow is designed to represent the cash flow a firm generates from its day-to-day operating activities. Interest expense arises from a financing decision and thus is considered as a cash flow to creditors.

AACSB: Reflective Thinking
 Blooms: Apply
 Difficulty: 2 Intermediate
 Section: 2.5 Cash Flow of the Firm
 Topic: Operating cash flow

88. Explain why the income statement is not a good representation of cash flow.

Most income statements contain some noncash items, so these must be accounted for when calculating cash flows. More importantly, however, since GAAP is used to create income statements, revenues and expenses are booked when they accrue, not when their corresponding cash flows occur.

AACSB: Reflective Thinking
 Blooms: Analyze
 Difficulty: 2 Intermediate
 Section: 2.5 Cash Flow of the Firm
 Topic: Cash flows

89. Discuss the difference between book values and market values on the balance sheet and explain the best method for determining the value of a firm to its stockholders.

The accounts on the balance sheet are generally carried at historical cost, not market values. Although the book value of current assets and current liabilities may closely approximate market values, the same cannot be said for the rest of the balance sheet accounts. Ultimately, stockholders should focus on the firm's stock price, which is a market value measure, for the value of their investment in the firm.

AACSB: Reflective Thinking
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.1 The Balance Sheet
Topic: Market and book values

90. Note that in all of our cash flow computations to determine cash flow of the firm, we never include the addition to retained earnings. Why not? Is this an oversight?

The addition to retained earnings is not a cash flow. It is simply an accounting entry that links the income statement to the balance sheet and allows the balance sheet to balance. Any additions to retained earnings will show up as cash flow changes in other balance sheet accounts.

AACSB: Reflective Thinking
Blooms: Analyze
Difficulty: 3 Challenge
Section: 2.2 The Income Statement
Topic: Income statement

91. Depreciation is classified as a noncash item because no cash is spent when depreciation is recorded. Why are expenses that have been accrued, but not yet paid, not also considered to be noncash items and therefore excluded from operating cash flow just as depreciation is excluded?

Accrued expenses that have not been paid will appear in accounts payable and the change in net working capital. Via the change in net working capital, these unpaid expenses are subtracted from the operating cash flow to determine the cash flow of the firm. This method allows for the computation of the cash flows based solely on financial statement information. Depreciation, on the other hand, is the expensing of a fixed asset cost that was paid for when the asset was acquired.

AACSB: Reflective Thinking
Blooms: Evaluate
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow

92. Sometimes when businesses are critically delinquent on their tax liabilities, the tax authority comes in and literally seizes the business by chasing all of the employees out of the building and changing the locks. What does this tell you about the importance of taxes relative to our discussion of cash flow? Why might a business owner want to avoid such an occurrence?

Taxes must be paid in cash, and in this case, they are one of the most important components of cash flow. The reputation of a business can undergo irreparable harm if word gets out that the tax authorities have confiscated the business, even if only for a couple of hours until the business owner can come up with the money to clear up the tax problem. The bottom line is if the owner can't come up with the cash, the tax authority has effectively put them out of business.

AACSB: Reflective Thinking
Blooms: Analyze
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flows

93. Interpret, in words, what cash flow of the firm represents by discussing operating cash flow, changes in net working capital, and additions to fixed assets.

Operating cash flow is the cash flow a firm generates from its day-to-day operations. In other words, it is the cash inflow generated as a result of putting the firm's assets to work. Changes in net working capital and fixed assets represent investments a firm makes in these assets. That is, a firm typically takes some of the cash flow it generates from using assets and reinvests it in new assets. Cash flow of the firm, then, is the cash flow a firm generates by employing its assets, net of any acquisitions.

AACSB: Reflective Thinking
Blooms: Evaluate
Difficulty: 2 Intermediate
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets

94. Why is cash flow management important?

GAAP accounting principles allow significant subjective decisions to be made in many key areas. The use of cash flow as a metric to evaluate a company comes from the idea that there is less subjectivity involved and therefore, it is harder to spin the numbers.

AACSB: Reflective Thinking

Blooms: Analyze

Difficulty: 2 Intermediate

Section: 2.7 Cash Flow Management

Topic: Cash flows

95. Explain the difference between product costs and period costs as they relate to the income statement. Are these terms synonymous with short-run and long-run?

Product costs are the total production costs incurred during a period - raw materials, direct labor, and manufacturing overhead - and are reported as cost of goods sold. Period costs are costs - management and office salaries, office expenses, insurance - that are allocated to a time period and are recorded as selling, general, and administrative expenses. The terms short-run and long-run are used to differentiate between fixed and variable costs, depending upon the length of time required to vary the cost amount.

AACSB: Reflective Thinking

Blooms: Apply

Difficulty: 2 Intermediate

Section: 2.2 The Income Statement

Topic: Income statement

Chapter 02 Test Bank - Static Summary

<u>Category</u>	<u># of Questions</u>
AACSB: Analytical Thinking	85
AACSB: Reflective Thinking	10
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Blooms: Apply	9
Blooms: Evaluate	2
Blooms: Remember	20
Blooms: Understand	28
Difficulty: 1 Basic	19
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