Test Bank for Corporate Finance 12th Ross

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Corporate Finance, 12e **(Ross)**
Chapter 2 Financial Statements and Cash Flow

1) Which one of these accounts appears on the right-hand side of a balance sheet?
A) Property, plant, and equipment
B) Accumulated retained earnings
C) Accumulated depreciation
D) Cash and equivalents
E) Intangible assets

Answer: B
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

2) The entire book value of the residual ownership of a corporation is known as the:
A) total equity.
B) intangible assets.
C) retained earnings.
D) capital surplus.
E) total assets.

Answer: A
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Understand
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3) Which account represents the book value of all of a corporation's net profits less its dividend payments?
A) Capital surplus
B) Accumulated retained earnings
C) Treasury stock
D) Common stock
E) Preferred stock

Answer: B
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Understand
AACSB: Reflective Thinking
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4) Which one of the following is a current liability?
A) Amount due to a supplier in 18 months
B) Note payable in nine months
C) Estimated taxes just paid
D) Loan payment due in 13 months
E) Amount due from a customer in 30 days

Answer: B
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Understand
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5) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
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6) Which one of the following assets is generally the most liquid?
A) Inventory
B) Buildings
C) Accounts receivable
D) Equipment
E) Patents

Answer: C
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Liquidity
Bloom's: Understand
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7) Which one of the following statements concerning liquidity is correct?
A) Liquid assets generally earn higher rates of return than fixed assets.
B) If you can sell an asset next year at a price equal to its actual value, the asset is highly liquid.
C) Liquid assets are defined as those assets obtained within the past year.
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.

Answer: E
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Liquidity
Bloom's: Understand
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8) 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 most associated with intangible assets.

Answer: D
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Liquidity
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9) 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) Dividends paid

Answer: D
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Remember
AACSB: Reflective Thinking
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10) 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 whenever the market value of an asset changes.

Answer: B
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Market and book values
Bloom's: Understand
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11) 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

Answer: A
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Market and book values
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12) Which one of these equations is an accurate expression of the balance sheet?
A) Assets ≡ Liabilities − Stockholders' equity
B) Stockholders' equity ≡ Assets + Liabilities
C) Liabilities ≡ Stockholders' equity − Assets
D) Assets ≡ Stockholders' equity − Liabilities
E) Stockholders' equity ≡ Assets − Liabilities

Answer: E
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Remember
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Accessibility: Keyboard Navigation

13) Which one of these accounts is classified as a fixed asset on the balance sheet?
A) Intangible assets
B) Accounts payable
C) Preferred stock
D) Inventory
E) Accounts receivable

Answer: A
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Remember
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14) 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.

Answer: C
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
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15) If a firm's financial managers successfully meet their primary goal, then the firm's:
A) debts will exceed its equity.
B) market value will exceed its book value.
C) net working capital will exceed its long-term debt.
D) carrying value will exceed its market value.
E) equity will exceed its assets.

Answer: B
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Market and book values
Bloom's: Remember
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16) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Liquidity
Bloom's: Remember
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17) Which one of these is related to an increase in 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

Answer: B
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Market and book values
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18) Assets are listed on the balance sheet in order of:
A) decreasing liquidity.
B) acquisition.
C) increasing size.
D) market value relative to book value.
E) book value.

Answer: A
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Liquidity
Bloom's: Understand
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19) An increase in treasury stock:
A) increases the total equity of the firm.
B) is the result of a firm issuing new shares of 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.

Answer: D
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Understand
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20) The book value of assets:
A) is determined under Generally Accepted Accounting Principles (GAAP) and is based on the cost of those assets.
B) represents the true market value of those assets 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.

Answer: A
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Generally Accepted Accounting Principles (GAAP)
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21) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.1 The Balance Sheet
Topic: Generally Accepted Accounting Principles (GAAP)
Bloom's: Understand
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22) 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.

Answer: E
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Understand
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23) 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.

Answer: B
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Generally Accepted Accounting Principles (GAAP)
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24) 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.

Answer: A
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Remember
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25) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Noncash items
Bloom's: Remember
AACSB: Reflective Thinking
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26) For a firm with long-term debt, net income must be equal to:
A) Pretax income − Interest expense − Taxes.
B) EBIT − Taxes.
C) Taxes + Addition to retained earnings.
D) Operating income × (1 − Marginal tax rate).
E) Dividends + Addition to retained earnings.

Answer: E
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Income statement
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27) As seen on the income statement of a tax-paying firm:
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 pays interest.
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.

Answer: D
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Understand
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28) All else held constant, the earnings per share will decrease as the:
A) net income increases.
B) number of shares outstanding increases.
C) total revenue of the firm increases.
D) tax rate decreases.
E) costs decrease.

Answer: B
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Per-share valuations
Bloom's: Understand
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29) 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.

Answer: E
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Per-share valuations
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30) Earnings per share:
A) will increase if net income increases and the number of shares outstanding decreases.
B) will increase if net income decreases and the 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 net income.

Answer: A
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Per-share valuations
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

31) 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.

Answer: A
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Per-share valuations
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

32) Assuming the number of shares outstanding and total earnings remains constant, an increase in dividends per share will:
A) reduce the earnings per share.
B) reduce the addition to retained earnings.
C) reduce net income.
D) increase total equity.
E) increase total assets.

Answer: B
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Per-share valuations
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33) Which one of these is a non-cash item?
A) Deferred taxes
B) Interest expense
C) Current taxes
D) Dividends
E) Selling expenses

Answer: A
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Noncash items
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

34) For a tax-paying firm, an increase in the depreciation expense of $1 will:
A) reduce net income by $1.
B) increase net income by $1.
C) reduce net income by more than $1.
D) reduce net income by less than $1.
E) increase net income by less than $1.

Answer: D
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Noncash items
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

35) According to Generally Accepted Accounting Principles (GAAP), the cost of goods sold expenses are:
A) recorded as incurred.
B) recorded when paid.
C) matched with revenues.
D) matched with production levels.
E) expensed as management desires.

Answer: C
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Generally Accepted Accounting Principles (GAAP)
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36) Depreciation for a profitable firm:
A) decreases both operating and net income.
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.

Answer: A
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Noncash items
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

37) Which one of these is most apt to be a fixed, cash expense in the short run?
A) Raw materials cost
B) Bond interest
C) Commissions paid to sales representatives
D) Depreciation
E) Manufacturing labor costs

Answer: B
Difficulty: 1 Easy
Section: 2.2 The Income Statement
Topic: Fixed and variable costs
Bloom's: Understand
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38) When you are making a financial decision, the most relevant tax rate is the _____ rate when the tax rate schedule is progressive.
A) average
B) fixed
C) marginal
D) total
E) variable

Answer: C
Difficulty: 1 Easy
Section: 2.3 Taxes
Topic: Taxes
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39) 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

Answer: E
Difficulty: 1 Easy
Section: 2.3 Taxes
Topic: Taxes
Bloom's: Remember
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40) As of 2018, the U.S. corporate tax rate is:
A) based on a progressive tax rate schedule.
B) based on a tiered, multi-rate flat tax.
C) a flat tax of 34 percent.
D) zero with all corporate taxable income passed to shareholders.
E) a flat rate of 21 percent.

Answer: E
Difficulty: 1 Easy
Section: 2.3 Taxes
Topic: Taxes
Bloom's: Remember
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41) A firm starts its year with 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 must 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.

Answer: E
Difficulty: 1 Easy
Section: 2.4 Net Working Capital
Topic: Net working capital
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42) For a growing firm, the change in net working capital is generally:
A) positive.
B) negative.
C) highly erratic.
D) highly negative.
E) equal to zero.

Answer: A
Difficulty: 1 Easy
Section: 2.4 Net Working Capital
Topic: Net working capital
Bloom's: Remember
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43) An increase in which one of the following will cause the operating cash flow to increase for a profitable firm?
A) Depreciation
B) Cash
C) Net working capital
D) Taxes
E) Administrative expenses

Answer: A
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

44) Which one of these does *not* affect the cash flow to creditors?
A) Interest paid on long-term debt
B) New mortgage on a building
C) Increase in accounts payable
D) Mortgage interest payment
E) Reduction in long-term debt

Answer: C
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors
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45) 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.

Answer: E
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

46) Which one of these will cause an increase in the cash flow to creditors for the current year?
A) Collection of a refund for the overpayment of a loan
B) Payoff of a 36-month loan after the first 15 months
C) Payment of a late charge on an account payable to a supplier
D) Acquiring a new loan that will be repaid in one lump sum 24 months from now
E) Purchasing inventory using credit offered by a supplier

Answer: B
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

47) 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 exceeds the cash flow to creditors.
E) both the cash flow to assets and the cash flow to creditors are positive.

Answer: D
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders
Bloom's: Understand
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48) 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.

Answer: B
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
Bloom's: Understand
AACSB: Reflective Thinking
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49) 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.

Answer: B
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
Bloom's: Understand
AACSB: Reflective Thinking
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50) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders
Bloom's: Understand
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51) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Free cash flow
Bloom's: Remember
AACSB: Reflective Thinking
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52) The cash flow of the firm must be equal to the:
A) cash flow to stockholders minus the cash flow to creditors.
B) cash flow to creditors minus the cash flow to stockholders.
C) cash flow to governments plus the cash flow to stockholders.
D) cash flow to stockholders plus the cash flow to creditors.
E) aftertax operating cash flow.

Answer: D
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

53) 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) free cash flow.
E) cash flow to investors.

Answer: A
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Remember
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54) 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 plus depreciation.
E) beginning total assets plus asset purchases minus asset sales.

Answer: B
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

55) 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.

Answer: C
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

56) Payments to creditors that include interest and the repayment of principal are referred to as:
A) the cash flow to stockholders.
B) the reduction in net working capital.
C) debt service.
D) operating cash flow.
E) the change in net working capital.

Answer: C
Difficulty: 1 Easy
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

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57) 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 operations
E) Cash flow to investors

Answer: D
Difficulty: 1 Easy
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

58) The accounting 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.

Answer: A
Difficulty: 1 Easy
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows
Bloom's: Understand
AACSB: Reflective Thinking
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59) In the accounting statement of cash flows, interest expense is:
A) ignored completely.
B) included as a financing activity.
C) included both as an operating and as a financing activity.
D) included as an investing activity.
E) included in operations.

Answer: E
Difficulty: 1 Easy
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows
Bloom's: Understand
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60) 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.

Answer: D
Difficulty: 1 Easy
Section: 2.7 Cash Flow Management
Topic: Cash flows
Bloom's: Understand
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

61) Total equity is $1,620, fixed assets are $1,810, long-term debt is $650, and short-term debt is $300. What is the amount of current assets?
A) $760
B) $360
C) $1,140
D) $480
E) $790

Answer: A
Explanation: Current assets = $1,620 + 650 + 300 − 1,810
Current assets = $760
Difficulty: 2 Medium
Section: 2.1 The Balance Sheet
Topic: Balance sheet
Bloom's: Apply
AACSB: Knowledge Application
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62) Southwest Co. has equipment with a book value of $3,560 that could be sold today for $3,900. Its inventory is valued at $1,780 and could be sold immediately to a competitor at a discount of 25 percent. The firm has $260 in cash and customers owe the firm $950, of which 98 percent is collectible. What is the current market value of the firm's assets?
A) $6,086
B) $5,536
C) $6,426
D) $6,316
E) $5,946

Answer: C
Explanation: Market value of assets = $260 + .98($950) + (1 − .25)($1,780) + $3,900
Market value of assets = $6,426
Difficulty: 2 Medium
Section: 2.1 The Balance Sheet
Topic: Market and book values
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

63) 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

Answer: B
Explanation: Book value of equity = $400 + 2,700 − 2,300
Book value of equity = $800
Difficulty: 2 Medium
Section: 2.1 The Balance Sheet
Topic: Market and book values
Bloom's: Apply
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64) 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 21 percent. What is the net income?
A) $221,200
B) $146,150
C) $105,000
D) $179,250
E) $139,050

Answer: B
Explanation: Net income = ($820,000 − 540,000 − 59,000 − 36,000)(1 − .21)
Net income = $146,150
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Apply
AACSB: Knowledge Application
Accessibility: Keyboard Navigation

65) Upton Industries has revenues of $42,629, interest expense of $1,230, depreciation of $2,609, cost of goods sold of $23,704, dividends paid of $1,200, and administrative expenses of $7,040. Assume the tax rate is 22 percent. What is the addition to retained earnings?
A) $5,075.88
B) $4,630.19
C) $3,766.67
D) $4,903.18
E) $5,230.04

Answer: A
Explanation: Net income = ($42,629 − 23,704 − 7,040 − 2,609 − 1,230)(1 − .22)
Net income = $6,275.88
Addition to retained earnings = $6,275.88 − 1,200
Addition to retained earnings = $5,075.88
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Apply
AACSB: Knowledge Application
Accessibility: Keyboard Navigation

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66) This year, Johnson Mills has annual revenue of $37,800, cost of goods sold of $23,200, and administrative expenses of $6,300. The firm paid $700 in dividends, $280 in interest, and has a total tax rate of 21 percent. The firm will add $2,810 to retained earnings. What is the depreciation expense?
A) $2,300
B) $3,709
C) $2,640
D) $780
E) $3,577

Answer: E
Explanation: Net income = $700 + 2,810
Net income = $3,510
Pretax income = $3,510/(1 − .21)
Pretax income = $4,443
Depreciation expense = $37,800 − 23,200 − 6,300 − 280 − 4,443
Depreciation expense = $3,577
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

67) Delfinio's has total revenues of $4,315, selling and administrative expenses of $611, depreciation of $309, cost of goods sold of $2,403, taxes of $178, dividends of $80, and interest expense of $168. What is the amount of the non-cash items?
A) $481
B) $477
C) $248
D) $309
E) $567

Answer: D
Explanation: Non-cash items = Depreciation = $309
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Noncash items
Bloom's: Apply
AACSB: Knowledge Application
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68) 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 total tax rate was 23 percent?
A) $20,225
B) $24,385
C) $18,457
D) $14,815
E) $21,393

Answer: C
Explanation: Net income = $285 + 411
Net income = $696
Pretax income = $696/(1 − .23)
Pretax income = $904
COGS = $24,646 − 4,370 − 812 − 103 − 904
COGS = $18,457
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

69) Daniels Transport has operating income of $68,200, interest expense of $210, dividends paid of $320, depreciation of $12,400, other income of $2,100, common stock of $48,500 with a par value of $1 per share, and retained earnings of $29,700. What is the earnings per share if the tax rate is 21 percent?
A) $1.14
B) $1.21
C) $.82
D) $.96
E) $1.33

Answer: A
Explanation: Net income = ($68,200 + 2,100 − 210)(1 − .21)
Net income = $55,371.10
EPS = $55,371.10/($48,500/$1)
EPS = $1.14
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Per-share valuations
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70) Given the personal income tax rates as shown, what is the average tax rate for an individual with taxable income of $118,700?

Taxable Income			Tax Rate
$ 0	−	9,525	10%
9,526	−	38,700	12
38,701	−	82,500	22
82,501	−	157,500	24

A) 24.00 percent
B) 22.36 percent
C) 19.00 percent
D) 21.94 percent
E) 21.00 percent

Answer: C
Explanation: Tax = .10($9,525) + .12($38,700 − 9,525) + .22($82,500 − 38,700) + .24($118,700 − 82,500)
Tax = $22,777.50
Average tax rate = $22,777.50/$118,700
Average tax rate = .19, or 19%
Difficulty: 2 Medium
Section: 2.3 Taxes
Topic: Taxes
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71) AC Motors is a sole proprietorship that has taxable income of $94,200. How much additional tax will be owed if the taxable income increases by $14,300 based on the following tax rates? Assume this is the sole source of income for the owner.

Taxable Income			Tax Rate
$ 0	−	9,525	10%
9,526	−	38,700	12
38,701	−	82,500	22
82,501	−	157,500	24

A) $3,862
B) $3,039
C) $3,406
D) $3,432
E) $3,678

Answer: D
Explanation: Additional tax = .24($14,300)
Additional tax = $3,432
Difficulty: 2 Medium
Section: 2.3 Taxes
Topic: Taxes
Bloom's: Analyze
AACSB: Analytical Thinking
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72) Assume Juno's paid $368,060 in taxes on taxable income of $1,673,000 last year. This year, the firm paid $401,545 in taxes on taxable income of $1,818,586. Assume the tax rates were the same for both years. What are the marginal and average tax rates for this year?
A) 21 percent; 21 percent
B) 22 percent; 21 percent
C) 23 percent; 22 percent
D) 22 percent; 22 percent
E) 23 percent; 21 percent

Answer: C
Explanation: Marginal tax rate = ($401,545 − 368,060)/($1,818,586 − 1,673,000)
Marginal tax rate = .23, or 23%
Average tax rate = $401,545/$1,818,586
Average tax rate = .22, or 22%
Difficulty: 2 Medium
Section: 2.3 Taxes
Topic: Taxes
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73) 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

Answer: E
Explanation: NWC = $360 + 1,210 + 820 − 890
NWC = $1,500
Difficulty: 2 Medium
Section: 2.4 Net Working Capital
Topic: Net working capital
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

74) A firm has $820 in inventory, $3,200 in fixed assets, $670 in accounts receivable, $390 in accounts payable, $500 in long-term debt, and $360 in cash. What is the amount of the net working capital?
A) $890
B) $960
C) $3,600
D) $3,340
E) $1,460

Answer: E
Explanation: NWC = $360 + 670 + 820 − 390
NWC = $1,460
Difficulty: 2 Medium
Section: 2.4 Net Working Capital
Topic: Net working capital
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75) At the beginning of the year, a firm had total assets of $51,400, fixed assets of $32,800, and current liabilities of $13,280. At the end of the year, the current assets are $14,800, the fixed assets are $34,100, and the current liabilities are $14,210. What is the change in net working capital for the year?
A) −$18,930
B) −$6,950
C) $11,470
D) −$4,730
E) $9,110

Answer: D
Explanation: ΔNWC = ($14,800 − 14,210) − ($51,400 − 32,800 − 13,280)
ΔNWC = −$4,730
Difficulty: 2 Medium
Section: 2.4 Net Working Capital
Topic: Net working capital
Bloom's: Analyze
AACSB: Analytical Thinking
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76) Blauser's started the year with $280 in cash, $924 in inventory, $361 in accounts payable, $1,687 in equipment, and $414 in accounts receivable. At year's end, the firm had $311 in cash, $1,594 in equipment, $1,003 in inventory, $426 in accounts receivable, and $398 in accounts payable. What was the change in net working capital during the year?
A) −$860
B) $191
C) $85
D) −$94
E) −$206

Answer: C
Explanation: ΔNWC = ($311 + 426 + 1,003 − 398) − ($280 + 414 + 924 − 361)
ΔNWC = $85
Difficulty: 2 Medium
Section: 2.4 Net Working Capital
Topic: Net working capital
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77) Foxglove Interiors has net fixed assets of $38,215, long-term debt of $22,400, cash of $560, accounts payable $4,611, inventory of $11,408, and accounts receivable of $3,462. How much net working capital does the firm have?
A) $11,634
B) $26,634
C) $13,117
D) $10,819
E) $14,736

Answer: D
Explanation: NWC = $560 + 3,462 + 11,408 − 4,611
NWC = $10,819
Difficulty: 2 Medium
Section: 2.4 Net Working Capital
Topic: Net working capital
Bloom's: Apply
AACSB: Knowledge Application
Accessibility: Keyboard Navigation

78) A debt-free firm has total sales of $22,980, costs of $14,715, and depreciation of $6,045. What is the operating cash flow at a tax rate of 23 percent?
A) $1,465.20
B) $2,410.80
C) $8,340.00
D) $7,754.40
E) $9,019.80

Answer: D
Explanation: EBIT = $22,980 − 14,715 − 6,045
EBIT = $2,220
Tax = $2,220(.23)
Tax = $510.60
OCF = $2,220 + 6,045 − 510.60
OCF = $7,754.40
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
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79) Awnings Inc. 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

Answer: C
Explanation: Net capital spending = $243,600 − 234,100 + 62,500
Net capital spending = $72,000
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

80) 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

Answer: E
Explanation: CF(*B*) = $40 − ($2,800 − 2,400)
CF(*B*) = −$360
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors
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81) 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

Answer: A
Explanation: CF(*B*) = $30 − ($790 − 840)
CF(*B*) = $80
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors
Bloom's: Analyze
AACSB: Analytical Thinking
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82) For the year, 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 and also paid $210 in interest. During the year, the company repurchased $500 worth of common stock and borrowed $250. What is the cash flow to stockholders?
A) $2,933
B) $1,893
C) $1,933
D) $2,433
E) $2,893

Answer: A
Explanation: CF(*S*) = .30($8,110) − (−$500)
CF(*S*) = $2,933
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders
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83) 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

Answer: A
Explanation: CF(*A*) = $11,618 − 6,180 − (−$420)
CF(*A*) = $5,858
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
Bloom's: Analyze
AACSB: Analytical Thinking
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84) Lester's Markets has total revenues of $3,811, costs of $2,902, depreciation of $315, interest expense of $168, and taxes of $89. At the beginning of the year, the firm had current assets of $2,150, total assets of $4,908, and total liabilities of $1,964. At the end of the year, the current assets are $2,202, total assets are $5,103, and total liabilities are $1,952. What is the amount of net capital spending for the year?
A) −$182
B) $133
C) $458
D) $510
E) $285

Answer: C
Explanation: Net capital spending = ($5,103 − 2,202) − ($4,908 − 2,150) + $315
Net capital spending = $458
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending
Bloom's: Analyze
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85) The General Store has total revenue of $4,116, depreciation of $319, selling and administrative expenses of $554, interest expense of $162, dividends of $75, cost of goods sold of $2,354, and taxes of $186. What is the operating cash flow?
A) $1,118
B) $795
C) $1,147
D) $1,022
E) $720

Answer: D
Explanation: OCF = $4,116 − 2,354 − 554 − 186
OCF = $1,022
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Apply
AACSB: Knowledge Application
Accessibility: Keyboard Navigation

86) Right Way Movers has interest expense of $168, total revenues of $38,411, costs of $28,515, depreciation of $306, and taxes of $1,979. The beginning balance sheet has total assets of $48,354, net fixed assets of $31,202, current liabilities of $14,207, and total liabilities of $29,407. The ending balance sheet shows total assets of $49,305, net fixed assets of $33,406, current liabilities of $17,318, and total liabilities of $30,404. What is the annual cash flow of the firm?
A) $9,771
B) −$2,160
C) $15,168
D) $8,474
E) $2,857

Answer: A
Explanation: OCF = $38,411 − 28,515 − 1,979
OCF = $7,917
Net capital spending = $33,406 − 31,202 + 306
Net capital spending = $2,510
ΔNWC = ($49,305 − 33,406 − 17,318) − ($48,354 − 31,202 − 14,207)
ΔNWC = −$4,364
CF(*A*) = $7,917 − 2,510 − (−$4,364)
CF(*A*) = $9,771
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
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87) For a given year, Mfg. Corp. had taxable income of $1,630 and a tax rate of 23 percent. The firm neither issued nor repurchased shares of stock but did decrease its retained earnings by $310. What is the cash flow to stockholders?
A) $1,749.50
B) $535.50
C) $959.50
D) $1,242.50
E) $1,565.10

Answer: E
Explanation: Net income = $1,630(1 − .23)
Net income = $1,255.10
CF(*S*) = $1,255.10 − (−$310)
CF(*S*) = $1,565.10
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

88) Northern Express paid $85 in dividends and $110 in interest expense during a given year. During that same year, the firm issued $40 in new equity shares, issued new debt of $65, and repaid $23 of old debt. What is the cash flow to creditors for that year?
A) $152
B) $146
C) $237
D) $68
E) $46

Answer: D
Explanation: CF(*B*) = $110 − ($65 − 23)
CF(*B*) = $68
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors
Bloom's: Analyze
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89) At the beginning of this year, Blauser Industries had net fixed assets of $21,506 and total assets of $32,687. At year's end, net fixed assets are $20,492 and total assets are $32,915. The annual depreciation expense is $1,520. What is net capital spending for this year?
A) −$850
B) $506
C) −$1,292
D) −$2,534
E) $1,748

Answer: B
Explanation: Net capital spending = $20,492 − 21,506 + 1,520
Net capital spending = $506
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Capital spending
Bloom's: Apply
AACSB: Knowledge Application
Accessibility: Keyboard Navigation

90) For the year, Jensen's has depreciation of $2,058, dividends paid of $125, interest expense of $382, an addition to retained earnings of $3,408, and an increase in common stock of $2,500. The total tax rate is 21 percent. What is the operating cash flow?
A) $6,460
B) $5,973
C) $5,325
D) $5,735
E) $6,408

Answer: B
Explanation: Net income = $125 + 3,408
Net income = $3,533
Pre-tax income = $3,533/(1 − .21)
Pre-tax income = $4,472.15
EBIT = $4,472.15 + 382
EBIT = $4,854.15
OCF = $4,854.15 + 2,058 − ($4,472.15 − 3,533)
OCF = $5,973
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Analyze
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91) Ledger Properties has the following financial information:

	Current Year	Prior Year
Revenues	$ 48,915	$ 43,610
Administrative expenses	12,106	11,602
Interest expense	816	468
Cost of goods sold	29,715	26,309
Depreciation	1,408	1,387
Net fixed assets	32,711	31,984
Current liabilities	14,652	14,625
Common stock	15,000	14,000
Current assets	16,506	14,687
Long-term debt	12,200	?
Retained earnings	7,365	4,246
Dividends paid	290	275

What is the cash flow of the firm for the current year if the tax rate is 22 percent?
A) $1,885
B) $1,042
C) $2,297
D) $2,096
E) $2,517

Answer: D
Explanation: Pretax income = $48,915 − 29,715 − 12,106 − 1,408 − 816
Pretax income = $4,870
Tax = .22($4,870)
Tax = $1,071
OCF = $48,915 − 29,715 − 12,106 − 1,071
OCF = $6,023
Net capital spending = $32,711 − 31,984 + 1,408
Net capital spending = $2,135
Change in NWC = ($16,506 − 14,652) − ($14,687 − 14,625)
Change in NWC = $1,792
Cash flow of the firm = $6,023 − 2,135 − 1,792
Cash flow of the firm = $2,096
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
Bloom's: Analyze
AACSB: Analytical Thinking
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92) For a given year, Rogers Express paid $318 in interest, $460 in dividends, and $368 in taxes. The firm had a net income of $1,220, depreciation of $1,560, an increase in net working capital of $220, an increase in net fixed assets of $950, and a decrease in long-term debt of $260. There were no changes in the equity accounts other than the change in retained earnings. What is the annual cash flow of the firm?
A) $3,148
B) $1,610
C) $2,780
D) $1,038
E) $50

Answer: D
Explanation: CF(*B*) = $318 + 260
CF(*B*) = $578
CF(S) = $460
CF(A) = $578 + 460
CF(A) = $1,038
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
Bloom's: Analyze
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93) JK Meadows has beginning current liabilities of $14,602 and total liabilities of $35,418. At the end of the year, the current liabilities are $15,311 and the total liabilities are $37,604. During the year, the firm paid $680 in dividends and $1,320 in interest. What is the cash flow to creditors?
A) $3,230
B) $2,797
C) $3,135
D) −$157
E) −$267

Answer: D
Explanation: CFC = $1,320 − [($37,604 − 15,311) − ($35,418 − 14,602)]
CFC = −$157
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to creditors
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94) During the year, Lasko's repaid $12,500 in long-term debt, borrowed $8,400, paid $611 in interest and $740 in dividends, and had an operating cash flow of $16,207. The firm acquired $33,500 in new fixed assets and sold $8,400 of old assets. Net working capital declined by $1,592 during the year. What is the annual cash flow to stockholders?
A) $1,200
B) −$2,590
C) −$8,828
D) −$12,012
E) $2,800

Answer: D
Explanation: Cash flow of the firm = $16,207 − 33,500 + 8,400 − (−$1,592)
Cash flow of the firm = −$7,301
CFC = $611 + 12,500 − 8,400
CFC = $4,711
CFS = −$7,301 − 4,711
CFS = −$12,012
Difficulty: 3 Hard
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow to stockholders
Bloom's: Evaluate
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95) 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 $2,646. What was the operating cash flow?
A) $21,500
B) $18,300
C) $23,100
D) $21,554
E) $23,700

Answer: D
Explanation: OCF = $87,200 − 54,700 − 8,300 − 2,646
OCF = $21,554
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
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96) Last year, Oscar's Dog Treats had a cash flow to creditors of $2,840 and a cash flow to stockholders of $1,630. 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) $4,901

Answer: B
Explanation: CF(*A*) = $2,840 + 1,630
CF(*A*)= $4,470
$4,470 = OCF − $1,420 − (−$330)
OCF = $5,560
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Analyze
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97) Quick Marts increased its cash by $418 this year. The firm's statement of cash flows shows total cash flow from financing activities of $246 and total cash flow from investing activities of −$184. What is the total cash flow from operations on this accounting statement?
A) $480
B) $356
C) $427
D) $367
E) $391

Answer: B
Explanation: $418 = Total cash flow from operations − 184 + 246
Total cash flow from operations = $356
Difficulty: 2 Medium
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows
Bloom's: Apply
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98) JJ's has net sales of $48,920, depreciation of $711, cost of goods sold of $31,890, administrative costs of $11,210, interest expense of $680, dividends paid of $450, and taxes of $974. What is the cash flow from operations as it will appear on the accounting statement of cash flows if the firm spent $274 on net working capital?
A) $3,892
B) $3,056
C) $4,066
D) $3,667
E) $3,391

Answer: A
Explanation: Cash flow from operations = $48,920 − 31,890 − 11,210 − 680 − 974 − 274
Cash flow from operations = $3,892
Note that the accounting statement of cash flows includes the interest expense as an operating activity.
Difficulty: 2 Medium
Section: 2.6 The Accounting Statement of Cash Flows
Topic: Statement of cash flows
Bloom's: Analyze
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99) 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.

Answer: 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 can be sold for at least its recorded book value.
Difficulty: 2 Medium
Section: 2.1 The Balance Sheet
Topic: Liquidity
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100) 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.

Answer: 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.
Difficulty: 2 Medium
Section: 2.1 The Balance Sheet
Topic: Market and book values
Bloom's: Analyze
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101) Note that in all of our computations to determine the cash flows of a firm, we never include the addition to retained earnings. Why not? Is this an oversight?

Answer: 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 shows that the earnings of the firm accrue to stockholders.
Difficulty: 2 Medium
Section: 2.2 The Income Statement
Topic: Income statement
Bloom's: Analyze
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102) From a financial perspective, why is interest expense excluded from the operating cash flow?

Answer: Operating cash flow is designed to represent the cash flow a firm generates from its day-to-day operations. Interest expense arises from a financing decision and thus is considered in finance as a cash flow to creditors.
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
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103) Explain why the income statement is not a good representation of cash flow.

Answer: Most income statements contain some noncash items, such as depreciation, which reduce net income but do not affect the cash flows. More importantly, however, income statements are prepared using GAAP guidelines which record revenues and expenses as sales are completed, not when their corresponding cash flows occur.
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flows
Bloom's: Analyze
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104) 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?

Answer: Accrued expenses will appear in accounts payable and affect 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 which is generally easy to obtain. Depreciation, on the other hand, is the expensing of a fixed asset cost that was paid for when the asset was acquired.
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Operating cash flow
Bloom's: Analyze
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105) Interpret, in words, what the cash flow of the firm represents by discussing operating cash flow, changes in net working capital, and additions to fixed assets.

Answer: Operating cash flow is the cash flow a firm generates from its day-to-day operations. In other words, it is the cash flow generated as a result of putting the firm's assets to work. Changes in net working capital and fixed assets represent investments a firm needs for its operations. 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 asset acquisitions.
Difficulty: 2 Medium
Section: 2.5 Cash Flow of the Firm
Topic: Cash flow from assets
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106) Why is cash flow management important?

Answer: Generally Accepted Accounting Principles (GAAP) 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.
Difficulty: 2 Medium
Section: 2.7 Cash Flow Management
Topic: Cash flows
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