Test Bank for Foundations of Financial Management 17th Block

Access Complete Test Bank for Foundations of Financial Management 17th Block

Foundations of Financial Management, 17e **(Block)**
Chapter 2 Review of Accounting

1) The income statement is the major device for measuring the profitability of a firm over a period of time.

2) The income statement shows the amount of profits earned based on any one given day.

3) Sales minus cost of goods sold is equal to earnings before taxes.

4) Sales minus cost of goods sold is equal to gross profit.

5) It is not possible for a company with a high gross profit margin to have a low operating profit.

6) Gross profit margin is a measurement of how much gross profit a company generated from the amount of sales it earned.

7) Operating profit is essentially a measure of how efficient management is in generating revenues and controlling expenses.

8) Another way of writing *net income after tax* is *earnings after taxes (EAT).*

9) Dividing earnings after taxes (which includes all profits distributed to both preferred stockholders and common stockholders) by common shares outstanding produces earnings per share.

10) The price-earnings (P/E) ratio is strongly related to the past performance of the firm.

11) Accounting income is based on verifiably completed transactions.

12) When a firm has a sharp drop off in earnings, its P/E ratio may be artificially high.

13) The P/E ratio provides no indication of investors' expectations about the future of a company.

14) The real value of a firm is the same from an economic and accounting perspective.

15) A balance sheet represents the assets, liabilities, and owner's equity of a company at a given point in time.

16) A balance sheet represents what the firm owns, owes, and ownership of a company at a given date.

17) Liquidity means that the items that can convert to cash show up as cash on the balance sheet.

18) The investments account includes marketable securities.

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19) The long-term investments account represents a commitment of funds of at least one year or more.

20) Asset accounts are listed in order of their liquidity.

21) Accumulated depreciation shows up in the income statement, while depreciation expense shows up on the balance sheet.

22) Accumulated depreciation should always be equal to the depreciation expense charged in the income statement.

23) Total assets of a firm are paid for with liabilities and stockholders' equity.

24) Marketable securities are short term investments and are valued on the balance sheet at their original purchase price.

25) Book value per share of stock and market value per share of stock are usually the same dollar amount.

26) Book value per share of stock is of greater concern to the financial manager than market value per share of stock.

27) Book value of a company is equal to net worth of a company, which is not always equal to the market value of the company.

28) Equity is a measure of the monetary contributions that have been made directly or indirectly on behalf of the owners of the company.

29) Stockholders equity is equal to liabilities plus assets.

30) Stockholders equity is equal to assets minus liabilities.

31) Retained earnings shown on the balance sheet represents profits generated from prior year's earnings less any prior dividends.

32) Balance sheet items should be adjusted for inflation when valuing a company.

33) Balance sheet items consider inflation and market value when assigning the amount to assets, liabilities, and equity accounts.

34) Cash and cash equivalents are considered anything that can convert to cash within one year.

35) The Statement of Cash Flows has three parts: operating, investing, and financing under both the indirect and direct method.

36) The statement of cash flows helps measure how the changes in a balance sheet accounts were financed between two time periods, the beginning and the ending balance.

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37) Cash flow from operations is equal to earnings before taxes minus depreciation.

38) The indirect method of preparing the Cash Flow Statement basically adjusts the net income to reflect what the financials would have looked like if cash basis was used instead of accrual basis.

39) Assume that two companies both have a net income of $100,000. The firm with the highest depreciation expense will have the highest cash flow, assuming all other adjustments are equal.

40) An increase in assets represents a positive source of funds.

41) An increase in a liability account represents a source of positive funds on the cash flow statement.

42) The purchase of a new factory building would reduce the cash flows from investing activities on the statement of cash flows.

43) Paying cash dividends to common shareholders will not affect the Cash Flow Statement.

44) The sale of a firm's securities is a source of positive funds, whereas the purchase of securities is a use of funds.

45) Depreciation is an accrual accounting entry that does not affect the cash account so it needs to be adjusted for when using the indirect method of the Cash Flow Statement.

46) Free cash flow is equal to cash flow from operating activities plus depreciation.

47) Free cash flow is equal to cash flow from operating activities minus necessary capital expenditures and normal dividend payments.

48) Beginning in 2018, one of the major changes regarding the corporate tax rate was its reduction from 35% to a flat rate of 21%.

49) The corporate tax rate change of 2018 means that corporations are no longer responsible to pay state and foreign taxes.

50) For corporations with low taxable income (less than $50,000), the effective tax rate can be as much as 40%.

51) The corporate tax rate reduction to a flat rate of 21% in 2018 was done to make the U.S. corporate tax rate more competitive with rates imposed by other countries and to encourage economic activity in the U.S.

52) Interest expense is deductible before taxes and therefore has an after-tax cost equal to the interest paid times (1 - tax rate).

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53) Federal corporate tax rates have changed several times since 1980.

54) A $125,000 credit sale could be a part of a firm's cash flow from operations if money is received within the firm's same fiscal year.

55) Preferred stock dividends are tax deductible.

56) Book value per share is the most important measure of value of a firm for a stockholder.

57) An increase in accounts receivable results in a cash inflow on the statement of cash flows.

58) A decrease in bonds payable results in a cash outflow on the statement of cash flows.

59) An increase in accrued expenses results in a cash outflow on the statement of cash flows.

60) A cash flow statement is considered correct if the change in cash flow plus the beginning balance ties to the ending cash balance.

61) Although depreciation does not provide cash to the firm directly, the fact that it is tax-deductible can provide cash inflow to the company.

62) Gross profit is equal to
A) sales minus cost of goods sold.
B) sales minus selling and administrative expenses.
C) sales minus cost of goods sold and selling and administrative expenses.
D) sales minus cost of goods sold and depreciation expense.

63) Which of the following is not subtracted in arriving at operating income?
A) Interest expense
B) Cost of goods sold
C) Depreciation
D) Selling and administrative expense

64) Increasing interest expense will have what effect on Earnings Before Interest and Taxes (EBIT)?
A) Increase it.
B) Decrease it.
C) It will have no effect.
D) There is not enough information to tell.

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65) Allen Lumber Company had earnings after taxes of $750,000 in the year 2015 with 300,000 shares outstanding on December 31, 2015. On January 1, 2016, the firm issued 50,000 new shares. The company took the proceeds from these new shares as well as other operating improvements and earned $937,500 earnings after taxes in 2016. Earnings per share for the year 2016 were
A) $2.14.
B) $2.68.
C) $3.13.
D) None of the options.

66) Consider the following information for Ball Corp.

Selling and administrative expense	$ 40,000
Depreciation expense	70,000
Sales	350,000
Interest expense	30,000
Cost of goods sold	110,000
Taxes	17,500

What is the operating profit for Ball Corp.?
A) $71,450
B) $90,000
C) $130,000
D) None of the options

67) Candy Company had sales of $320,000 and cost of goods sold of $112,000. What is the gross profit margin (ratio of gross profit to sales)?
A) 55%
B) 65%
C) 35%
D) 73.3%

68) Density Farms Inc. had sales of $750,000, cost of goods sold of $200,000, selling and administrative expense of $70,000, and operating profit of $150,000. What was the value of depreciation expense?
A) $150,000
B) $230,000
C) $330,000
D) $0

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69) Elgin Battery Manufacturers had sales of $1,000,000 in 2015 and their cost of goods sold is $700,000. Selling and administrative expenses were $100,000. Depreciation expense was $80,000 and interest expense for the year was $10,000. The firm's tax rate is 30 percent. What is the dollar amount of taxes paid in 2015?
A) $36,000
B) $117,800
C) $33,000
D) $300,000

70) A firm has $1,500,000 in its common stock account and $1,000,000 in its capital paid in excess of par account. The firm issued 100,000 shares of common stock. What was the issue price (market value) if only one stock issuance has occurred?
A) $35 per share
B) $25 per share
C) $15 per share
D) Not enough information to determine

71) A firm has $4,000 in its common stock account and $10,000 in its paid-in capital account. The firm issued 1,000 shares of common stock. What is the par value of the common stock?
A) $40 per share
B) $10 per share
C) $4 per share
D) $14 per share

72) A firm with earnings per share of $3 and a price-earnings (P/E) ratio of 24 will have a stock market price of
A) $72.00.
B) $15.00.
C) $6.67.
D) $3.00.

73) Earnings per share is
A) operating profit divided by number of shares outstanding.
B) net income divided by number of shares outstanding.
C) net income divided by stockholders' equity.
D) net income minus preferred dividends divided by number of shares outstanding.

74) Price-earnings (P/E) ratio is influenced by all of the following BUT
A) the business risk the firm takes on.
B) earnings per share.
C) quality of management.
D) All of the options are true.

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75) Reinvested funds into retained earnings theoretically belong to
A) bond holders.
B) common stockholders.
C) employees.
D) All of the options

76) When a firm's earnings are falling more rapidly than its stock price, its P/E ratio will
A) remain the same.
B) go up.
C) go down.
D) either go up or down.

77) Which of the following factors do not influence the firm's P/E ratio?
A) Past earnings
B) Shares outstanding
C) Volatility in business performance
D) All of the options influence the firm's P/E ratio.

78) Which of the following would not be classified as a current asset?
A) Marketable securities
B) Plant property and equipment
C) Prepaid expenses
D) Inventory

79) An item which may be converted to cash within one year or one operating cycle of the firm is classified as a
A) current liability.
B) long-term asset.
C) current asset.
D) long-term liability.

80) Asset accounts on the balance sheet are listed in order of
A) liquidity.
B) profitability.
C) dollar amount.
D) importance.

81) Which of the following is not a primary source of raising money or capital for the firm?
A) Assets
B) Common stock
C) Preferred stock
D) Bonds

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82) How many of the following balance sheet items are classified as a current asset or current liability?

- Retained earnings
- Accounts payable
- Plant and equipment
- Inventory
- Common stock
- Bonds payable
- Accrued wages payable
- Accounts receivable
- Preferred stock

A) Three of these items.
B) Four of these items.
C) Five of these items.
D) Six of these items.

83) How many of the following items are found on the balance sheet, rather than the income statement?

- Accounts receivable
- Retained earnings
- Income tax expense
- Accrued payable
- Cash
- Selling and administrative expenses
- Plant and equipment
- Operating expense
- Marketable securities
- Interest expense

A) Three of these items are found on the balance sheet.
B) Four of these items are found on the balance sheet.
C) Five of these items are found on the balance sheet.
D) Six of these items are found on the balance sheet.

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84) How many of the following items are found on the income statement, rather than the balance sheet?

- Sales
- Notes payable (due in six months)
- Bonds payable (mature in 10 years)
- Common stock
- Depreciation expense
- Inventories
- Capital in excess of par value
- Net income (earnings after taxes)
- Income tax payable

A) Two of these items are found on the income statement.
B) Three of these items are found on the income statement.
C) Four of these items are found on the income statement.
D) Five of these items are found on the income statement.

85) Which account represents the cumulative earnings of the firm since the firm started, minus dividends paid?
A) Paid-in capital
B) Common stock
C) Retained earnings
D) Accumulated depreciation

86) The major limitation of financial statements are
A) their complexity.
B) their lack of comparability.
C) their use of historical cost accounting.
D) their lack of detail.

87) Net worth is equal to stockholders' equity
A) plus dividends.
B) minus preferred stock.
C) plus preferred stock.
D) minus liabilities.

88) Book value is the same as
A) stockholders' equity.
B) fixed assets minus long-term debt.
C) net worth.
D) current assets minus current debt.

89) Total stockholders' equity consists of
A) preferred stock and common stock.
B) common stock and retained earnings.
C) common stock, preferred stock, and capital paid in excess of par.
D) preferred stock, common stock, capital paid in excess of par, and retained earnings.

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90) The net worth of a firm
A) is usually the same as the firm's market value.
B) is based on current asset costs.
C) is based on current assets less current liabilities.
D) None of the options

91) The book value per share is based off of _____ data, while the market value per share is based off of _____ data.
A) short term; long term
B) future; historical
C) historical; future
D) long term; short term

92) The primary disadvantage of accrual accounting is that
A) it does not match revenues and expenses in the period in which they are incurred.
B) it does not appropriately measure accounting profit.
C) it does not recognize accounts receivable.
D) it does not adequately show the actual cash flows of the firm.

93) The statement of cash flows does not include which of the following sections?
A) Cash flows from operating activities
B) Cash flows from sales activities
C) Cash flows from investing activities
D) Cash flows from financing activities

94) Which of the following is an outflow of cash?
A) Profitable operations
B) The sale of equipment
C) The sale of the company's common stock
D) The payment of cash dividends

95) Which of the following is an inflow of cash?
A) Funds spent in normal business operations
B) The purchase of a new factory
C) The sale of the firm's bonds
D) The retirement of the firm's bonds

96) A statement of cash flows allows a financial analyst to determine
A) whether a cash dividend is affordable.
B) how increases in assets have been financed.
C) whether long-term assets are being financed with long-term or short-term financing.
D) All of the options

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97) Which of the following would represent a use of funds and, indirectly, a reduction in cash balances?
A) An increase in inventories
B) A decrease in marketable securities
C) An increase in accounts payable
D) The sale of new bonds by the firm

98) Which of the following would represent a positive source of funds and, indirectly, an increase in cash balances?
A) A reduction in accounts receivable
B) The repurchase of shares of the firm's stock
C) A decrease in net income
D) A reduction in notes payable

99) A firm's purchase of plant and equipment would be considered a
A) use of cash for financing activities.
B) use of cash for operating activities.
C) source of cash for operating activities.
D) use of cash for investment activities.

100) How many of the following items decrease cash flow in the statement of cash flows?

- Increase in accounts receivable
- Increase in notes payable
- Depreciation expense
- Increase in investments
- Decrease in accounts payable
- Decrease in prepaid expenses
- Dividend payment
- Increase in accrued expenses

A) Two of these items decrease cash flow
B) Three of these items decrease cash flow
C) Four of these items decrease cash flow
D) Five of these items decrease cash flow

101) Depreciation is a source of cash inflow because
A) it is a non-cash expense, so it needs to be added back to net income when using the indirect method.
B) it supplies cash for future asset purchases.
C) it is a tax-deductible cash expense.
D) it is a taxable expense.

102) Preferred stock dividends _____ earnings available to common stockholders.
A) increase
B) decrease
C) do not effect
D) There is not enough information to determine.

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103) Free cash flow is used to help determine:

- the amount of cash that is generated from the business operations, including normal sales and normal costs, payments made to owners, and purchases of property.
- the amount of cash that is available for extra activities that the firm may want to get involved in.
- the amount of cash that is considered taxable for federal income taxes.

A) Option I only
B) Option II only
C) Options I and III
D) Options I and II.

104) Given the following, what is free cash flow?

Cash flow from operating activities	$ 200,000
Cash flow from investing activities	$ 140,000
Cash flow from financing activities	$ 56,000
Building purchases	$ 50,000
Dividends Paid	$ 20,000

A) $396,000
B) $270,000
C) $326,000
D) $130,000

105) Assuming a tax rate of 21%, depreciation expenses of $500,000 will
A) reduce income by $15,000.
B) reduce taxes by $105,000.
C) reduce taxes by $150,000.
D) have no effect on income or taxes, since depreciation is not a cash expense.

106) Assuming a tax rate of 21%, the after-tax cost of interest expense of $1,000,000 is
A) $1,000,000
B) $79,000
C) $790,000
D) $400,000

107) Assuming a tax rate of 21%, the after-tax cost of a $100,000 dividend payment is
A) $100,000
B) $70,000
C) $30,000
D) None of the options

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108) Farah Snack Co. has earnings after taxes of $150,000. Interest expense for the year was $20,000; preferred dividends paid were $20,000; and common dividends paid were $30,000. Taxes were $22,500. The firm has 100,000 shares of common stock outstanding. Earnings per share on the common stock was
A) $1.30.
B) $1.10.
C) $0.75.
D) $0.80.

109) Gerry Co. has a gross profit of $1,200,000 and depreciation expense of $400,000. Selling and administrative expense is $250,000. Given that the tax rate is 21 percent, compute the cash flow from operations for Gerry Co.
A) $834,500
B) $550,000
C) $330,000
D) None of the options

110) Hoover Inc. has current assets of $350,000 and fixed plant assets of $650,000. Current liabilities are $100,000 and long-term liabilities are $250,000. There is $120,000 in preferred stock outstanding and the firm has issued 10,000 shares of common stock. What is the firm's total equity?
A) $1,000,000.
B) $530,000
C) $350,000
D) $650,000

111) Hoover Inc. has current assets of $350,000 and fixed plant assets of $650,000. Current liabilities are $100,000 and long-term liabilities are $250,000. There is $120,000 in preferred stock outstanding and the firm has issued 10,000 shares of common stock. Compute book value (net worth) per share
A) $84.00.
B) $53.00.
C) $75.00.
D) $65.00.

112) The best indication of the operational efficiency of management is
A) net income.
B) earnings per share.
C) earnings before interest and taxes (EBIT).
D) gross profit.

113) Which of the following would indicate an accurate statement of cash flows?
A) Net cash flow is equal to marketable securities balance
B) Net cash flows from financing activities are equal to the change in stockholder's equity
C) Net cash flow is equal to the ending cash balance
D) Net cash flow is equal to the change in the cash balance

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114) An increase of $100,000 in inventory would result in a(n)
A) Decrease of net cash flow.
B) Increase in net cash flow.
C) Decrease in marketable securities.
D) Increase in bonds payable.

115) Compute the cash flows from operations using the indirect method if Star Corporation had $250,000 in net income, $30,000 in depreciation expense, a decrease of $20,000 in accounts receivable and an increase in bonds payable of $50,000.
A) $370,000
B) $300,000
C) $250,000
D) $310,000

116) One of the *primary* factors evaluated when a company is pursuing a leveraged buyout is
A) Net cash flow.
B) Free cash flow.
C) Cash flow from financing activities.
D) Cash flow from investing activities.

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Foundations of Financial Management, 17e **(Block)**
Chapter 2 Review of Accounting

1) The income statement is the major device for measuring the profitability of a firm over a period of time.

Answer: TRUE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

2) The income statement shows the amount of profits earned based on any one given day.

Answer: FALSE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

3) Sales minus cost of goods sold is equal to earnings before taxes.

Answer: FALSE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

4) Sales minus cost of goods sold is equal to gross profit.

Answer: TRUE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

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5) It is not possible for a company with a high gross profit margin to have a low operating profit.

Answer: FALSE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

6) Gross profit margin is a measurement of how much gross profit a company generated from the amount of sales it earned.

Answer: TRUE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

7) Operating profit is essentially a measure of how efficient management is in generating revenues and controlling expenses.

Answer: TRUE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

8) Another way of writing *net income after tax* is *earnings after taxes (EAT).*

Answer: TRUE
Difficulty: 1 Easy
Topic: Per-share valuations
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
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9) Dividing earnings after taxes (which includes all profits distributed to both preferred stockholders and common stockholders) by common shares outstanding produces earnings per share.

Answer: FALSE
Difficulty: 1 Easy
Topic: Per-share valuations
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

10) The price-earnings (P/E) ratio is strongly related to the past performance of the firm.

Answer: FALSE
Difficulty: 1 Easy
Topic: Market value ratios
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

11) Accounting income is based on verifiably completed transactions.

Answer: TRUE
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

12) When a firm has a sharp drop off in earnings, its P/E ratio may be artificially high.

Answer: TRUE
Difficulty: 1 Easy
Topic: Market value ratios
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Apply
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13) The P/E ratio provides no indication of investors' expectations about the future of a company.

Answer: FALSE
Difficulty: 1 Easy
Topic: Market value ratios
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

14) The real value of a firm is the same from an economic and accounting perspective.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

15) A balance sheet represents the assets, liabilities, and owner's equity of a company at a given point in time.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

16) A balance sheet represents what the firm owns, owes, and ownership of a company at a given date.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
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17) Liquidity means that the items that can convert to cash show up as cash on the balance sheet.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

18) The investments account includes marketable securities.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Knowledge
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

19) The long-term investments account represents a commitment of funds of at least one year or more.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

20) Asset accounts are listed in order of their liquidity.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

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21) Accumulated depreciation shows up in the income statement, while depreciation expense shows up on the balance sheet.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

22) Accumulated depreciation should always be equal to the depreciation expense charged in the income statement.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

23) Total assets of a firm are paid for with liabilities and stockholders' equity.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

24) Marketable securities are short term investments and are valued on the balance sheet at their original purchase price.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Knowledge
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25) Book value per share of stock and market value per share of stock are usually the same dollar amount.

Answer: FALSE
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

26) Book value per share of stock is of greater concern to the financial manager than market value per share of stock.

Answer: FALSE
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

27) Book value of a company is equal to net worth of a company, which is not always equal to the market value of the company.

Answer: TRUE
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

28) Equity is a measure of the monetary contributions that have been made directly or indirectly on behalf of the owners of the company.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Understand
AACSB: Analytical Thinking
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29) Stockholders equity is equal to liabilities plus assets.

Answer: FALSE
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

30) Stockholders equity is equal to assets minus liabilities.

Answer: TRUE
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

31) Retained earnings shown on the balance sheet represents profits generated from prior year's earnings less any prior dividends.

Answer: TRUE
Difficulty: 3 Hard
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply; Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

32) Balance sheet items should be adjusted for inflation when valuing a company.

Answer: TRUE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
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AACSB: Analytical Thinking
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33) Balance sheet items consider inflation and market value when assigning the amount to assets, liabilities, and equity accounts.

Answer: FALSE
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

34) Cash and cash equivalents are considered anything that can convert to cash within one year.

Answer: FALSE
Difficulty: 2 Medium
Topic: Cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

35) The Statement of Cash Flows has three parts: operating, investing, and financing under both the indirect and direct method.

Answer: TRUE
Difficulty: 2 Medium
Topic: Cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

36) The statement of cash flows helps measure how the changes in a balance sheet accounts were financed between two time periods, the beginning and the ending balance.

Answer: TRUE
Difficulty: 1 Easy
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
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37) Cash flow from operations is equal to earnings before taxes minus depreciation.

Answer: FALSE
Difficulty: 2 Medium
Topic: Cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

38) The indirect method of preparing the Cash Flow Statement basically adjusts the net income to reflect what the financials would have looked like if cash basis was used instead of accrual basis.

Answer: TRUE
Difficulty: 2 Medium
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

39) Assume that two companies both have a net income of $100,000. The firm with the highest depreciation expense will have the highest cash flow, assuming all other adjustments are equal.

Answer: TRUE
Difficulty: 3 Hard
Topic: Cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

40) An increase in assets represents a positive source of funds.

Answer: FALSE
Difficulty: 1 Easy
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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41) An increase in a liability account represents a source of positive funds on the cash flow statement.

Answer: TRUE
Difficulty: 2 Medium
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

42) The purchase of a new factory building would reduce the cash flows from investing activities on the statement of cash flows.

Answer: TRUE
Difficulty: 2 Medium
Topic: Investing activities
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

43) Paying cash dividends to common shareholders will not affect the Cash Flow Statement.

Answer: FALSE
Difficulty: 2 Medium
Topic: Financing activities
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

44) The sale of a firm's securities is a source of positive funds, whereas the purchase of securities is a use of funds.

Answer: TRUE
Difficulty: 2 Medium
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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45) Depreciation is an accrual accounting entry that does not affect the cash account so it needs to be adjusted for when using the indirect method of the Cash Flow Statement.

Answer: TRUE
Difficulty: 1 Easy
Topic: Noncash items
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

46) Free cash flow is equal to cash flow from operating activities plus depreciation.

Answer: FALSE
Difficulty: 2 Medium
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Remember
AACSB: Reflective Thinking
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47) Free cash flow is equal to cash flow from operating activities minus necessary capital expenditures and normal dividend payments.

Answer: TRUE
Difficulty: 2 Medium
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

48) Beginning in 2018, one of the major changes regarding the corporate tax rate was its reduction from 35% to a flat rate of 21%.

Answer: TRUE
Difficulty: 1 Easy
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
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49) The corporate tax rate change of 2018 means that corporations are no longer responsible to pay state and foreign taxes.

Answer: FALSE
Difficulty: 1 Easy
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Remember
AACSB: Reflective Thinking
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50) For corporations with low taxable income (less than $50,000), the effective tax rate can be as much as 40%.

Answer: FALSE
Difficulty: 2 Medium
Topic: Taxes
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

51) The corporate tax rate reduction to a flat rate of 21% in 2018 was done to make the U.S. corporate tax rate more competitive with rates imposed by other countries and to encourage economic activity in the U.S.

Answer: TRUE
Difficulty: 1 Easy
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
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52) Interest expense is deductible before taxes and therefore has an after-tax cost equal to the interest paid times (1 - tax rate).

Answer: TRUE
Difficulty: 2 Medium
Topic: Taxes
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

53) Federal corporate tax rates have changed several times since 1980.

Answer: TRUE
Difficulty: 1 Easy
Topic: Taxes
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

54) A $125,000 credit sale could be a part of a firm's cash flow from operations if money is received within the firm's same fiscal year.

Answer: TRUE
Difficulty: 3 Hard
Topic: Operating cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

55) Preferred stock dividends are tax deductible.

Answer: FALSE
Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
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56) Book value per share is the most important measure of value of a firm for a stockholder.

Answer: FALSE
Difficulty: 1 Easy
Topic: Market and book values
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

57) An increase in accounts receivable results in a cash inflow on the statement of cash flows.

Answer: FALSE
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
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58) A decrease in bonds payable results in a cash outflow on the statement of cash flows.

Answer: TRUE
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
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59) An increase in accrued expenses results in a cash outflow on the statement of cash flows.

Answer: FALSE
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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60) A cash flow statement is considered correct if the change in cash flow plus the beginning balance ties to the ending cash balance.

Answer: TRUE
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

61) Although depreciation does not provide cash to the firm directly, the fact that it is tax-deductible can provide cash inflow to the company.

Answer: TRUE
Difficulty: 2 Medium
Topic: Noncash items
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Understand
AACSB: Analytical Thinking
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62) Gross profit is equal to
A) sales minus cost of goods sold.
B) sales minus selling and administrative expenses.
C) sales minus cost of goods sold and selling and administrative expenses.
D) sales minus cost of goods sold and depreciation expense.

Answer: A
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Remember
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63) Which of the following is not subtracted in arriving at operating income?
A) Interest expense
B) Cost of goods sold
C) Depreciation
D) Selling and administrative expense

Answer: A
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

64) Increasing interest expense will have what effect on Earnings Before Interest and Taxes (EBIT)?
A) Increase it.
B) Decrease it.
C) It will have no effect.
D) There is not enough information to tell.

Answer: C
Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
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65) Allen Lumber Company had earnings after taxes of $750,000 in the year 2015 with 300,000 shares outstanding on December 31, 2015. On January 1, 2016, the firm issued 50,000 new shares. The company took the proceeds from these new shares as well as other operating improvements and earned $937,500 earnings after taxes in 2016. Earnings per share for the year 2016 were
A) $2.14.
B) $2.68.
C) $3.13.
D) None of the options.

Answer: B
Explanation: Year 2015
Earnings per share = (Earnings after taxes/Shares outstanding) = ($750,000/300,000) = $2.50

Year 2016
Earnings after taxes = $750,000 × 1.25 = $937,500
Shares outstanding = 300,000 + 50,000 = 350,000
Earnings per share = $937,500/350,000 = $2.68
Difficulty: 2 Medium
Topic: Per-share valuations
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
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66) Consider the following information for Ball Corp.

Selling and administrative expense	$ 40,000
Depreciation expense	70,000
Sales	350,000
Interest expense	30,000
Cost of goods sold	110,000
Taxes	17,500

What is the operating profit for Ball Corp.?
A) $71,450
B) $90,000
C) $130,000
D) None of the options

Answer: C
Explanation:

Sales	$ 350,000
Cost of goods sold	110,000
Gross Profit	240,000
Selling and administrative expense	40,000
Depreciation expense	70,000
Operating profit	$ 130,000

Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
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67) Candy Company had sales of $320,000 and cost of goods sold of $112,000. What is the gross profit margin (ratio of gross profit to sales)?
A) 55%
B) 65%
C) 35%
D) 73.3%

Answer: B
Explanation:

Sales	$ 320,000
Cost of goods sold	112,000
Gross Profit	$ 208,000

Gross Profit Margin = Gross Profit/Sales
= $208,000/$320,000 = 0.65
Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

68) Density Farms Inc. had sales of $750,000, cost of goods sold of $200,000, selling and administrative expense of $70,000, and operating profit of $150,000. What was the value of depreciation expense?
A) $150,000
B) $230,000
C) $330,000
D) $0

Answer: C
Explanation:

Sales	$ 750,000
Cost of goods sold	200,000
Gross Profit	550,000
Selling and administrative expense	70,000
Depreciation (plug figure)	330,000
Operating profit	$ 150,000

Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
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69) Elgin Battery Manufacturers had sales of $1,000,000 in 2015 and their cost of goods sold is $700,000. Selling and administrative expenses were $100,000. Depreciation expense was $80,000 and interest expense for the year was $10,000. The firm's tax rate is 30 percent. What is the dollar amount of taxes paid in 2015?
A) $36,000
B) $117,800
C) $33,000
D) $300,000

Answer: C
Explanation:

Sales	$ 1,000,000
Cost of goods sold (70%)	700,000
Gross Profit	300,000
Selling and administrative expense (10%)	100,000
Depreciation	80,000
Operating profit	$ 120,000
Interest	10,000
Earnings before tax	110,000
Taxes (30%)	$ 33,000

Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
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70) A firm has $1,500,000 in its common stock account and $1,000,000 in its capital paid in excess of par account. The firm issued 100,000 shares of common stock. What was the issue price (market value) if only one stock issuance has occurred?
A) $35 per share
B) $25 per share
C) $15 per share
D) Not enough information to determine

Answer: B
Explanation:
Original price = (Common stock + paid-in-capital)/number of shares outstanding
= ($1,500,000 + $1,000,000)/100,000 = $25
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

71) A firm has $4,000 in its common stock account and $10,000 in its paid-in capital account. The firm issued 1,000 shares of common stock. What is the par value of the common stock?
A) $40 per share
B) $10 per share
C) $4 per share
D) $14 per share

Answer: C
Explanation: Par value = Common stock/number of shares outstanding = $4,000/1,000 = $4
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-01 The income statement measures profitability.
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72) A firm with earnings per share of $3 and a price-earnings (P/E) ratio of 24 will have a stock market price of
A) $72.00.
B) $15.00.
C) $6.67.
D) $3.00.

Answer: A
Explanation: Stock price = EPS × P/E ratio = $3 × 24 = $72
Difficulty: 2 Medium
Topic: Market value ratios
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

73) Earnings per share is
A) operating profit divided by number of shares outstanding.
B) net income divided by number of shares outstanding.
C) net income divided by stockholders' equity.
D) net income minus preferred dividends divided by number of shares outstanding.

Answer: D
Difficulty: 2 Medium
Topic: Per-share valuations
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

74) Price-earnings (P/E) ratio is influenced by all of the following BUT
A) the business risk the firm takes on.
B) earnings per share.
C) quality of management.
D) All of the options are true.

Answer: D
Difficulty: 2 Medium
Topic: Per-share valuations
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
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75) Reinvested funds into retained earnings theoretically belong to
A) bond holders.
B) common stockholders.
C) employees.
D) All of the options

Answer: B
Difficulty: 1 Easy
Topic: Shareholder rights
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

76) When a firm's earnings are falling more rapidly than its stock price, its P/E ratio will
A) remain the same.
B) go up.
C) go down.
D) either go up or down.

Answer: B
Difficulty: 2 Medium
Topic: Market value ratios
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Bloom's: Understand
AACSB: Analytical Thinking
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77) Which of the following factors do not influence the firm's P/E ratio?
A) Past earnings
B) Shares outstanding
C) Volatility in business performance
D) All of the options influence the firm's P/E ratio.

Answer: D
Difficulty: 2 Medium
Topic: Market value ratios
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
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78) Which of the following would not be classified as a current asset?
A) Marketable securities
B) Plant property and equipment
C) Prepaid expenses
D) Inventory

Answer: B
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

79) An item which may be converted to cash within one year or one operating cycle of the firm is classified as a
A) current liability.
B) long-term asset.
C) current asset.
D) long-term liability.

Answer: C
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

80) Asset accounts on the balance sheet are listed in order of
A) liquidity.
B) profitability.
C) dollar amount.
D) importance.

Answer: A
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
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Access Complete Test Bank for Foundations of Financial Management 17th Block

81) Which of the following is not a primary source of raising money or capital for the firm?
A) Assets
B) Common stock
C) Preferred stock
D) Bonds

Answer: A
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

82) How many of the following balance sheet items are classified as a current asset or current liability?

- Retained earnings
- Accounts payable
- Plant and equipment
- Inventory
- Common stock
- Bonds payable
- Accrued wages payable
- Accounts receivable
- Preferred stock

A) Three of these items.
B) Four of these items.
C) Five of these items.
D) Six of these items.

Answer: B
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
AACSB: Reflective Thinking
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83) How many of the following items are found on the balance sheet, rather than the income statement?

- Accounts receivable
- Retained earnings
- Income tax expense
- Accrued payable
- Cash
- Selling and administrative expenses
- Plant and equipment
- Operating expense
- Marketable securities
- Interest expense

A) Three of these items are found on the balance sheet.
B) Four of these items are found on the balance sheet.
C) Five of these items are found on the balance sheet.
D) Six of these items are found on the balance sheet.

Answer: D
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
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84) How many of the following items are found on the income statement, rather than the balance sheet?

- Sales
- Notes payable (due in six months)
- Bonds payable (mature in 10 years)
- Common stock
- Depreciation expense
- Inventories
- Capital in excess of par value
- Net income (earnings after taxes)
- Income tax payable

A) Two of these items are found on the income statement.
B) Three of these items are found on the income statement.
C) Four of these items are found on the income statement.
D) Five of these items are found on the income statement.

Answer: B
Difficulty: 2 Medium
Topic: Income statement
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Remember
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85) Which account represents the cumulative earnings of the firm since the firm started, minus dividends paid?
A) Paid-in capital
B) Common stock
C) Retained earnings
D) Accumulated depreciation

Answer: C
Difficulty: 1 Easy
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
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86) The major limitation of financial statements are
A) their complexity.
B) their lack of comparability.
C) their use of historical cost accounting.
D) their lack of detail.

Answer: C
Difficulty: 2 Medium
Topic: Generally Accepted Accounting Principles (GAAP)
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

87) Net worth is equal to stockholders' equity
A) plus dividends.
B) minus preferred stock.
C) plus preferred stock.
D) minus liabilities.

Answer: B
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

88) Book value is the same as
A) stockholders' equity.
B) fixed assets minus long-term debt.
C) net worth.
D) current assets minus current debt.

Answer: C
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
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89) Total stockholders' equity consists of
A) preferred stock and common stock.
B) common stock and retained earnings.
C) common stock, preferred stock, and capital paid in excess of par.
D) preferred stock, common stock, capital paid in excess of par, and retained earnings.

Answer: D
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Understand
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90) The net worth of a firm
A) is usually the same as the firm's market value.
B) is based on current asset costs.
C) is based on current assets less current liabilities.
D) None of the options

Answer: D
Difficulty: 2 Medium
Topic: Balance sheet
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

91) The book value per share is based off of _____ data, while the market value per share is based off of _____ data.
A) short term; long term
B) future; historical
C) historical; future
D) long term; short term

Answer: C
Difficulty: 2 Medium
Topic: Market and book values
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
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92) The primary disadvantage of accrual accounting is that
A) it does not match revenues and expenses in the period in which they are incurred.
B) it does not appropriately measure accounting profit.
C) it does not recognize accounts receivable.
D) it does not adequately show the actual cash flows of the firm.

Answer: D
Difficulty: 2 Medium
Topic: Generally Accepted Accounting Principles (GAAP)
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

93) The statement of cash flows does not include which of the following sections?
A) Cash flows from operating activities
B) Cash flows from sales activities
C) Cash flows from investing activities
D) Cash flows from financing activities

Answer: B
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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94) Which of the following is an outflow of cash?
A) Profitable operations
B) The sale of equipment
C) The sale of the company's common stock
D) The payment of cash dividends

Answer: D
Difficulty: 1 Easy
Topic: Cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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95) Which of the following is an inflow of cash?
A) Funds spent in normal business operations
B) The purchase of a new factory
C) The sale of the firm's bonds
D) The retirement of the firm's bonds

Answer: C
Difficulty: 1 Easy
Topic: Cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
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96) A statement of cash flows allows a financial analyst to determine
A) whether a cash dividend is affordable.
B) how increases in assets have been financed.
C) whether long-term assets are being financed with long-term or short-term financing.
D) All of the options

Answer: D
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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97) Which of the following would represent a use of funds and, indirectly, a reduction in cash balances?
A) An increase in inventories
B) A decrease in marketable securities
C) An increase in accounts payable
D) The sale of new bonds by the firm

Answer: A
Difficulty: 2 Medium
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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98) Which of the following would represent a positive source of funds and, indirectly, an increase in cash balances?
A) A reduction in accounts receivable
B) The repurchase of shares of the firm's stock
C) A decrease in net income
D) A reduction in notes payable

Answer: A
Difficulty: 2 Medium
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

99) A firm's purchase of plant and equipment would be considered a
A) use of cash for financing activities.
B) use of cash for operating activities.
C) source of cash for operating activities.
D) use of cash for investment activities.

Answer: D
Difficulty: 2 Medium
Topic: Sources and uses of cash
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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100) How many of the following items decrease cash flow in the statement of cash flows?

- Increase in accounts receivable
- Increase in notes payable
- Depreciation expense
- Increase in investments
- Decrease in accounts payable
- Decrease in prepaid expenses
- Dividend payment
- Increase in accrued expenses

A) Two of these items decrease cash flow
B) Three of these items decrease cash flow
C) Four of these items decrease cash flow
D) Five of these items decrease cash flow

Answer: C
Difficulty: 3 Hard
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Remember
AACSB: Reflective Thinking
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101) Depreciation is a source of cash inflow because
A) it is a non-cash expense, so it needs to be added back to net income when using the indirect method.
B) it supplies cash for future asset purchases.
C) it is a tax-deductible cash expense.
D) it is a taxable expense.

Answer: A
Difficulty: 1 Easy
Topic: Noncash items
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
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102) Preferred stock dividends _____ earnings available to common stockholders.
A) increase
B) decrease
C) do not effect
D) There is not enough information to determine.

Answer: B
Difficulty: 1 Easy
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Understand
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

103) Free cash flow is used to help determine:

- the amount of cash that is generated from the business operations, including normal sales and normal costs, payments made to owners, and purchases of property.
- the amount of cash that is available for extra activities that the firm may want to get involved in.
- the amount of cash that is considered taxable for federal income taxes.

A) Option I only
B) Option II only
C) Options I and III
D) Options I and II.

Answer: D
Difficulty: 2 Medium
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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104) Given the following, what is free cash flow?

Cash flow from operating activities	$ 200,000
Cash flow from investing activities	$ 140,000
Cash flow from financing activities	$ 56,000
Building purchases	$ 50,000
Dividends Paid	$ 20,000

A) $396,000
B) $270,000
C) $326,000
D) $130,000

Answer: D
Explanation:

Cash flow from operations activities	$ 200,000
− Capital Expenditures	50,000
− Common stock dividends	20,000
Free Cash flow	$ 130,000

Difficulty: 2 Medium
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

105) Assuming a tax rate of 21%, depreciation expenses of $500,000 will
A) reduce income by $15,000.
B) reduce taxes by $105,000.
C) reduce taxes by $150,000.
D) have no effect on income or taxes, since depreciation is not a cash expense.

Answer: B
Explanation: Tax savings from depreciation = Depreciation × tax rate = $500,000 × 0.21 = $105,000
Difficulty: 1 Easy
Topic: Noncash items
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Apply
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106) Assuming a tax rate of 21%, the after-tax cost of interest expense of $1,000,000 is
A) $1,000,000
B) $79,000
C) $790,000
D) $400,000

Answer: C
Explanation: After tax cost of interest = Interest × (1 - tax rate) = $1,000,000 × 0.79 = $790,000
Difficulty: 1 Easy
Topic: Taxes
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

107) Assuming a tax rate of 21%, the after-tax cost of a $100,000 dividend payment is
A) $100,000
B) $70,000
C) $30,000
D) None of the options

Answer: A
Explanation: Dividends are not tax deductible.
Difficulty: 2 Medium
Topic: Taxes
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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108) Farah Snack Co. has earnings after taxes of $150,000. Interest expense for the year was $20,000; preferred dividends paid were $20,000; and common dividends paid were $30,000. Taxes were $22,500. The firm has 100,000 shares of common stock outstanding. Earnings per share on the common stock was
A) $1.30.
B) $1.10.
C) $0.75.
D) $0.80.

Answer: A
Explanation: Earnings after taxes − Preferred stock dividends = Earnings available to common
$150,000 − $20,000 = $130,000 EAC
Earnings per share = Earnings available to common/number of shares outstanding
$130,000/100,000 = $1.30
Difficulty: 3 Hard
Topic: Per-share valuations
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

109) Gerry Co. has a gross profit of $1,200,000 and depreciation expense of $400,000. Selling and administrative expense is $250,000. Given that the tax rate is 21 percent, compute the cash flow from operations for Gerry Co.
A) $834,500
B) $550,000
C) $330,000
D) None of the options

Answer: A
Explanation:

Gross Profit		1,200,000
Selling & administrative expense		250,000
Depreciation expense		400,000
Operating Profit	$	550,000
Taxes (21%)		115,500
Earnings after taxes	$	434,500
Plus depreciation expense		400,000
Cash Flow	$	834,500

Difficulty: 3 Hard
Topic: Operating cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
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110) Hoover Inc. has current assets of $350,000 and fixed plant assets of $650,000. Current liabilities are $100,000 and long-term liabilities are $250,000. There is $120,000 in preferred stock outstanding and the firm has issued 10,000 shares of common stock. What is the firm's total equity?
A) $1,000,000.
B) $530,000
C) $350,000
D) $650,000

Answer: D
Explanation: Equity = Assets − Liabilities or 350,000 + 650,000 − 100,000 − 250,000. The preferred stock is ignored.
Difficulty: 3 Hard
Topic: Market and book values
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
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Access Complete Test Bank for Foundations of Financial Management 17th Block

111) Hoover Inc. has current assets of $350,000 and fixed plant assets of $650,000. Current liabilities are $100,000 and long-term liabilities are $250,000. There is $120,000 in preferred stock outstanding and the firm has issued 10,000 shares of common stock. Compute book value (net worth) per share
A) $84.00.
B) $53.00.
C) $75.00.
D) $65.00.

Answer: B
Explanation:

Current assets	$ 350,000
Fixed assets	650,000
Total assets	$ 1,000,000
−Current liabilities	100,000
−Long-term liabilities	250,000
Stockholders' equity	$ 650,000
−Preferred stock obligation	120,000
Net worth assigned to common	$ 530,000
Common shares outstanding	10,000
Book value (net worth) per share	$ 53

Difficulty: 3 Hard
Topic: Market and book values
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

112) The best indication of the operational efficiency of management is
A) net income.
B) earnings per share.
C) earnings before interest and taxes (EBIT).
D) gross profit.

Answer: C
Difficulty: 3 Hard
Topic: Income statement
Learning Objective: 02-01 The income statement measures profitability.
Bloom's: Understand
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113) Which of the following would indicate an accurate statement of cash flows?
A) Net cash flow is equal to marketable securities balance
B) Net cash flows from financing activities are equal to the change in stockholder's equity
C) Net cash flow is equal to the ending cash balance
D) Net cash flow is equal to the change in the cash balance

Answer: D
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Analyze
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

114) An increase of $100,000 in inventory would result in a(n)
A) Decrease of net cash flow.
B) Increase in net cash flow.
C) Decrease in marketable securities.
D) Increase in bonds payable.

Answer: A
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Bloom's: Analyze
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115) Compute the cash flows from operations using the indirect method if Star Corporation had $250,000 in net income, $30,000 in depreciation expense, a decrease of $20,000 in accounts receivable and an increase in bonds payable of $50,000.
A) $370,000
B) $300,000
C) $250,000
D) $310,000

Answer: B
Explanation: Cash flow from operations = Net income + Depreciation + Decrease in A/R = $250,000 + $30,000 + $20,000 = $300,000.
Difficulty: 2 Medium
Topic: Statement of cash flows
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.; 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Bloom's: Apply
AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

116) One of the *primary* factors evaluated when a company is pursuing a leveraged buyout is
A) Net cash flow.
B) Free cash flow.
C) Cash flow from financing activities.
D) Cash flow from investing activities.

Answer: B
Difficulty: 2 Medium
Topic: Free cash flow
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
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