

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

TRUE

*AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement*

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

FALSE

*AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement*

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

FALSE

*AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement*

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

TRUE

*AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement*

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

FALSE

*AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement*

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

TRUE

*AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement*

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Per-share valuations

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.

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Per-share valuations

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Topic: Market value ratios

11. Accounting income is based on verifiably completed transactions.

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Topic: Market value ratios

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

18. The investments account includes marketable securities.

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Knowledge
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Knowledge
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Market and book values

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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Market and book values

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.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Basic
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Market and book values

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

29. Stockholders equity is equal to liabilities plus assets.

FALSE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

30. Stockholders equity is equal to assets minus liabilities.

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Blooms: Understand
Difficulty: Challenge
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Cash flows

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Cash flows

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.

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Cash flows

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.

TRUE

AACSB: Analytical Thinking

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.

TRUE

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

FALSE

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

TRUE

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

TRUE

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

FALSE

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

TRUE

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.

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Noncash items

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

FALSE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Free cash flow

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

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Free cash flow

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

FALSE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Taxes

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Taxes

50. Federal corporate tax rates have changed several times since 1980.

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic

51. 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.

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Challenge
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Operating cash flow

52. Preferred stock dividends are tax deductible.

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Market and book values

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

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

FALSE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

Full file at <https://testbankuniv.eu/Foundations-of-Financial-Management-16th-Edition-Block-Test-Bank>
57. A cash flow statement is considered correct if the change in cash flow plus the beginning balance ties to the ending cash balance.

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

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

TRUE

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Noncash items

59. 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.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

60. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

61. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

62. 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

Full file at <https://testbankuniv.eu/Foundations-of-Financial-Management-16th-Edition-Block-Test-Bank>
 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.

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

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Apply
 Difficulty: Intermediate
 Gradable: automatic
 Learning Objective: 02-01 The income statement measures profitability.
 Topic: Per-share valuations

63. 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

Sales.....	\$350,000
Cost of goods sold.....	<u>110,000</u>
Gross Profit.....	240,000
Selling and administrative expense.....	40,000
Depreciation expense.....	<u>70,000</u>
Operating profit.....	\$ 130,000

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Intermediate
 Gradable: automatic
 Learning Objective: 02-01 The income statement measures profitability.
 Topic: Income statement

64. 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%

Cost of goods sold.....	<u>112,000</u>
Gross Profit.....	\$208,000

$$\text{Gross Profit Margin} = \text{Gross Profit/Sales}$$

$$= \$208,000/\$320,000 = .65$$

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Intermediate
 Gradable: automatic
 Learning Objective: 02-01 The income statement measures profitability.
 Topic: Income statement

65. 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

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

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Intermediate
 Gradable: automatic
 Learning Objective: 02-01 The income statement measures profitability.
 Topic: Income statement

66. 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

Sales.....	\$1,000,000
Cost of goods sold (70%).....	<u>700,000</u>
Gross Profit	300,000
Selling and administrative expense (10%).....	100,000
Depreciation expense	<u>100,000</u>
Operating profit.....	\$ 100,000
Interest.....	<u>10,000</u>
Earnings before tax	90,000
Taxes (30%).....	\$27,000

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Intermediate
 Gradable: automatic

67. 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 has ever been sold?

- A. \$35 per share
- B. \$25 per share**
- C. \$15 per share
- D. Not enough information to determine

$$\begin{aligned}\text{Original price} &= (\text{Common stock} + \text{paid-in-capital})/\text{number of shares outstanding} \\ &= (\$1,500,000 + \$1,000,000)/100,000 = \$25\end{aligned}$$

AACSB: Analytical Thinking
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-01 The income statement measures profitability.
Topic: Market and book values

68. 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

$$\text{Par value} = \text{Common stock}/\text{number of shares outstanding} = \$4,000,000/1,000,000 = \$4$$

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-01 The income statement measures profitability.
Topic: Market and book values

69. 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.

$$\text{Stock price} = \text{EPS} \times \text{P/E ratio} = \$3 \times 20 = \$60$$

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.
Topic: Market value ratios

70. 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.**

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

71. 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.

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Intermediate

Gradable: automatic

Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.

Topic: Per-share valuations

72. Reinvested funds into retained earnings theoretically belong to

- A. bond holders.
- B.** common stockholders.
- C. employees.
- D. All of the options

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: Basic

Gradable: automatic

Learning Objective: 02-01 The income statement measures profitability.

Topic: Shareholder rights

73. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: Intermediate

Gradable: automatic

Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.

Topic: Market value ratios

74. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: Intermediate

Gradable: automatic

Learning Objective: 02-02 The price-earnings ratio indicates the relative valuation of earnings.

Topic: Market value ratios

75. 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

AACSB: Reflective Thinking

76. 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.

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Basic

Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

Topic: Balance sheet

77. Asset accounts on the balance sheet are listed in order of

- A. liquidity.**
- B. profitability.
- C. dollar amount.
- D. importance.

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Basic

Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

Topic: Balance sheet

78. 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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Basic

Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

Topic: Balance sheet

79. 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.

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

80. 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.

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Intermediate

Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

Topic: Balance sheet

81. 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.

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Intermediate

Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

Topic: Income statement

82. 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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: Basic

Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

Topic: Balance sheet

83. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-01 The income statement measures profitability.
Topic: Generally Accepted Accounting Principles (GAAP)

84. Net worth is equal to stockholders' equity

- A. plus dividends.
- B.** minus preferred stock.
- C. plus preferred stock.
- D. minus liabilities.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

85. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Market and book values

86. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Balance sheet

87. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.

88. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
Topic: Market and book values

89. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-01 The income statement measures profitability.
Topic: Generally Accepted Accounting Principles (GAAP)

90. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

91. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Cash flows

92. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic

93. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

94. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Sources and uses of cash

95. 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

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Sources and uses of cash

96. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Sources and uses of cash

97. 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

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Challenge
Gradable: automatic

Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Statement of cash flows

98. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic
Gradable: automatic

Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Noncash items

99. Preferred stock dividends _____ earnings available to common stockholders.

- A. increase
B. decrease
C. do not effect
D. There is not enough information to determine.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Basic
Gradable: automatic

Learning Objective: 02-01 The income statement measures profitability.
Topic: Income statement

100. Free cash flow is used to help determine:

- I. 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.
II. the amount of cash that is available for extra activities that the firm may want to get involved in.
III. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic

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

101. 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**

Feedback:	Cash flow from operations activities	\$200,000
	- Capital Expenditures	50,000
	- Common stock dividends	<u>20,000</u>
	Free cash flow	\$130,000

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Intermediate
 Gradable: automatic
 Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
 Topic: Free cash flow

102. Assuming a tax rate of 40%, depreciation expenses of \$500,000 will

- A. reduce income by \$200,000.
- B. reduce taxes by \$200,000.**
- C. reduce taxes by \$500,000.
- D. have no effect on income or taxes, since depreciation is not a cash expense.

Tax savings from depreciation = Depreciation × tax rate = \$500,000 × .40 = \$200,000

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Apply
 Difficulty: Basic
 Gradable: automatic
 Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
 Topic: Noncash items

103. Assuming a tax rate of 40%, the after-tax cost of interest expense of \$1,000,000 is

- A. \$1,000,000
- B. \$140,000
- C. \$600,000**
- D. \$400,000

After tax cost of interest = Interest × (1 - tax rate) = \$1,000,000 × .60 = \$600,000

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Apply
 Difficulty: Basic
 Gradable: automatic
 Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
 Topic: Taxes

104. Assuming a tax rate of 30%, 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

Dividends are not tax deductible.

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Apply
 Difficulty: Intermediate

105. 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.

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

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Apply
 Difficulty: Challenge
 Gradable: automatic
 Learning Objective: 02-01 The income statement measures profitability.
 Topic: Per-share valuations

106. 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 40 percent, compute the cash flow from operations for Gerry Co.

- A. \$730,000
- B. \$550,000
- C. \$330,000
- D. None of the options

Gross Profit.....	1,200,000
Selling and administrative expense.....	250,000
Depreciation expense	<u>400,000</u>
Operating profit.....	\$ 550,000
Taxes (40%).....	<u>220,000</u>
Earnings after taxes	\$ 330,000
Plus depreciation expense	<u>400,000</u>
Cash Flow.....	\$ 730,000

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Challenge
 Gradable: automatic
 Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
 Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
 Topic: Operating cash flow

107. 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

Equity = Assets - Liabilities or 350,000 + 650,000 - 100,000-250,000. The preferred stock is ignored.

AACSB: Analytical Thinking

Blooms: Apply
 Difficulty: Challenge
 Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
 Topic: Market and book values

108. 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.

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

AACSB: Analytical Thinking
 Blooms: Apply
 Difficulty: Challenge
 Gradable: automatic

Learning Objective: 02-03 The balance sheet shows assets and the financing of those assets with debt and equity.
 Topic: Market and book values

109. 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.

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Understand
 Difficulty: Challenge
 Gradable: automatic

Learning Objective: 02-01 The income statement measures profitability.
 Topic: Income statement

110. 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**

AACSB: Analytical Thinking
 Accessibility: Keyboard Navigation
 Blooms: Analyze
 Difficulty: Intermediate
 Gradable: automatic

Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
 Topic: Statement of cash flows

111. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Statement of cash flows

112. 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

Cash flow from operations = Net income + Depreciation + Decrease in A/R = \$250,000 + \$30,000 + \$20,000 = \$300,000.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Apply
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Learning Objective: 02-05 Depreciation provides a tax reduction benefit that increases cash flow.
Topic: Statement of cash flows

113. 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.

AACSB: Analytical Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Intermediate
Gradable: automatic
Learning Objective: 02-04 The statement of cash flows indicates changes in the cash position of the firm.
Topic: Free cash flow

Chapter 02 Test Bank - Static Summary

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