**Chapter 01 Test Bank**

1. Current liabilities are defined as liabilities with a maturity of less than one year.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

2.A decline in the Net fixed assets account between year-end 2016 and year-end 2017 is a clear indication that fixed assets were sold during 2017.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

3.When reporting financial performance for tax purposes, U.S. companies prefer to use accelerated depreciation methods over the straight-line method.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

4. Accounting rules require U.S. companies to depreciate research and development (R&D) expenditures using the straight-line method.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

5.You can construct a sources and uses statement for 2017 if you have a company’s year-end balance sheets for 2017 and 2018.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

6. A reduction in long-term debt is a use of cash.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatics*

7. The accrual principle requires that revenue not be recognized until payment from a sale is received.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

8. An increase in cash and cash equivalents should appear as a source of cash on the sources and uses statement.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

9. A cash flow statement places each source or use of cash into one of three broad categories: operating activities, investing activities, or financing activities.

**TRUE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

10. The cost of equity is usually reported on the income statement right below interest expense.

**FALSE**

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

11. Which of the following statements concerning the cash flow production cycle is true?

A. The profits reported in a given time period equal the cash flows generated.

B. A company’s operations and finances are independent of each other.

C. Financial statements have nothing to do with reality.

**D.** The movement of cash to inventory, to accounts receivable, and back to cash is known as the firm’s working capital cycle.

E. A profitable company will always have sufficient cash to meet its obligations.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

12. Which of the following statements concerning a firm’s cash flows and profits is false?

A. Managers must be at least as concerned with cash flows as with profits.

**B.** A company that sells merchandise at a profit will generate cash soon enough to replenish cash flows required for continued production.

C. The cash flows generated in a given time period can differ from the profits reported.

D. Profits are no assurance that cash flow will be sufficient to maintain solvency.

E. Due to required cash investments in current assets, fast-growing and profitable companies can literally "grow broke".

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

13. Which of the following is NOT a typical reason for differences between profits and cash flow?

**A.** Goodwill

B. Depreciation expense

C. Changes in accounts receivable

D. Accrual accounting practices

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

14.Which one of the following is the financial statement that shows a financial snapshot, taken at a point in time, of all the assets the company owns and all the claims against those assets?

A. income statement

B. creditor’s statement

**C.** balance sheet

D. cash flow statement

E. sources and uses statement

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

15. A balance sheet reports the value of a firm’s assets, liabilities, and equity

A. over an annual period.

B. over any period of time.

**C.** at any point in time.

D. at the end of the year.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

16.A company sells used equipment with a book value of $100,000 for $250,000 cash. How would this transaction affect the company’s balance sheet?

A. Equity rises $250,000; net plant and equipment falls $250,000.

**B.** Cash rises $250,000; net plant and equipment falls $100,000; equity rises $150,000.

C. Cash rises $250,000; accounts receivable falls $100,000; goodwill rises $150,000.

D. Cash rises $250,000; net plant and equipment falls $250,000.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

17. A company purchases a new $10 million building financed half with cash and half with a bank loan. How would this transaction affect the company’s balance sheet?

A. Net plant and equipment rises $10 million; cash falls $10 million; bank debt rises $5 million.

B. Net plant and equipment rises $5 million; cash falls $10 million; bank debt rises $5 million.

C. Net plant and equipment rises $5 million; cash falls $5 million; bank debt rises $5 million.

**D.** Net plant and equipment rises $10 million; cash falls $5 million; bank debt rises $5 million.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

18.Which one of the following is the financial statement that summarizes a firm’s revenue and expenses over a period of time?

**A.** income statement

B. balance sheet

C. cash flow statement

D. sources and uses statement

E. market value statement

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

19. The sources and uses of cash over a stated period of time are reflected in the

A. income statement.

B. balance sheet.

C. shareholders’ equity statement.

**D.** cash flow statement.

E. statement of operating position.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

20. Which one of the following is a source of cash?

A. increase in accounts receivable

B. decrease in notes payable

C. decrease in common stock

D. increase in inventory

**E.** increase in accounts payable

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

21. Which one of the following is a use of cash?

A. increase in notes payable

**B.** increase in inventory

C. increase in long-term debt

D. decrease in accounts receivable

E. increase in common stock

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

22. Which one of the following is a source of cash?

**A.** decrease in accounts receivable

B. decrease in common stock

C. decrease in long-term debt

D. decrease in accounts payable

E. increase in inventory

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

23. Which of the following would NOT be considered a use of cash?

A. Dividends paid

B. A decrease in accounts payable

**C.** Depreciation

D. An increase in the cash and marketable securities account

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

24. Which one of the following is the financial statement that summarizes changes in the company’s cash balance over a period of time?

A. income statement

B. balance sheet

**C.** cash flow statement

D. shareholders’ equity statement

E. market value statement

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

25. Which of the following is NOT a major category on the cash flow statement?

**A.** Cash flows from selling activities

B. Cash flows from operating activities

C. Cash flows from financing activities

D. Cash flows from investing activities

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

26. The book value of a firm is

A. equivalent to the firm’s market value provided that the firm has some fixed assets.

**B.** based on historical cost.

C. generally greater than the market value when fixed assets are included.

D. more of a financial than an accounting valuation.

E. adjusted to the market value whenever the market value exceeds the stated book value.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

27. Which of the following is a reason why a company’s market value of equity differs from its book value of equity?

A. Shareholders are keenly aware of book values but have little interest in market values.

B. Accountants’ charges for the cost of equity are often higher than they should be.

C. Fair value accounting is becoming more widely used.

**D.** Values of assets on the balance sheet typically reflect historical cost, adjusted for appropriate depreciation.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

28. Depreciation expense

**A.** reduces both taxes and net income.

B. increases net fixed assets as shown on the balance sheet.

C. is a noncash item that increases net income.

D. decreases current assets, net income, and operating cash flows.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

*[The following information applies to the questions displayed below.]*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Foodtek, Inc. |  |  |  |  |
| Selected financial information ($ millions) | | 2017 |  |  |
| Net sales | 2016 |  |  |
| $296 | $364 |  |  |
| Cost of goods sold | 168 | 223 |  |  |
| Depreciation | 51 | 65 |  |  |
| Net income | 32 | 45 |  |  |
| Finished goods inventory | 34 | 29 |  |  |
| Accounts receivable | 47 | 87 |  |  |
| Accounts payable | 39 | 44 |  |  |
| Net fixed assets | 310 | 415 |  |  |
| Year-end cash balance | $186 | $123 |  |  |

29. Please refer to the financial information for Foodtek, Inc. above. During 2017, how much cash (in millions of dollars) did Foodtek collect from sales?

A. 364

B. 277

C. 404

**D.** 324

E. 451

F. None of the options are correct.

In 2017, sales were $364 million, but account receivable rose $40 million, indicating that the company only received $324 million in cash. (This ignores possible changes in bad debt reserves.) Letting bop stand for beginning of period, and eop for end of period, the equation is (where AR = accounts receivable)

AReop = ARbop + Sales − Collections

Collections = Sales − Change in AR

$324 = $364 − $40

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

30. Please refer to the financial information for Foodtek, Inc. above. During 2017, what was the cost of merchandise (in millions of dollars) produced by Foodtek?

A. 223

B. 194

C. 252

D. 228

**E.** 218

F. None of the options are correct.

During 2017, the company sold $223 million of merchandise at cost, but finished goods inventory fell $5 million, indicating that the company only produced $218 million of merchandise. Letting bop stand for beginning of period, and eop for end of period, the equation is

Inventoryeop = Inventorybop+ Production − Cost of sales

Production = Cost of sales + Change in Inventory

$218 = $223 − $5

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

31. Please refer to the financial information for Foodtek, Inc. above. Assuming the company neither sold nor salvaged any assets during the year, what were Foodtek’s capital expenditures (in millions of dollars) during 2017?

A. 415

B. 105

C. 310

D. 40

**E.** 170

F. None of the options are correct.

Net fixed assets rose $105 million, depreciation reduced net fixed assets by $65 million, so capital expenditures must have been $170 million (ignoring asset sales or write-offs). Letting bop stand for beginning of period, and eop for end of period, the equation is

Net fixed assetseop = Net fixed assetsbop + Capital Expenditures - Depreciation

Capital Expenditures = Change in net fixed assets + Depreciation

$170 = $105 + $65

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

32. Please refer to the financial information for Foodtek, Inc. above. Assuming that there were no financing cash flows during 2017 and basing your answer solely on the information provided, what were Foodtek’s cash flows from operations (in millions of dollars) for 2017?

A. 45

B. 110

C. 70

**D.** 80

E. 35

F. None of the options are correct.

Cash flow from operations can be calculated directly from items in the table. Start with net income, remove any noncash items (such as depreciation), and add any cash transactions that are not captured by the income statement (such as changes to working capital accounts).

CF from operations = Net income - increase in acct. receivable - increase in inventory + increase in acct. payable + depreciation

CF from operations = 45 - 40 + 5 + 5 + 65 = $80 million

*Accessibility: Keyboard Navigation*

*Difficulty: 3 Hard*

*Gradable: automatic*

33. Suppose an acquiring firm pays $100 million for a target firm, and the target’s assets have a book value of $70 million and an estimated replacement value of $80 million. What amount would be allocated to the acquiring firm’s goodwill account?

A. $0 million

**B.** $20 million

C. $30 million

D. $70 million

E. $80 million

F. None of the options are correct.

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

34. JM Case Inc. has a market value of $5 million with 500,000 shares outstanding. The book value of its equity is $1,750,000. What is JM Case’s price per share?

A. $3.50

B. $5

**C.** $10

D. $25

E. $50

F. None of the options are correct.

Stock price per share = $5 million/500,000 shares = $10 per share

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

35. JM Case Inc. has a market value of $5 million with 500,000 shares outstanding. The book value of its equity is $1,750,000. What is JM Case’s book value per share?

**A.** $3.50

B. $5

C. $10

D. $25

E. $50

F. None of the options are correct.

Book value per share = $1,750,000/500,000 shares = $3.50 per share

*Accessibility: Keyboard Navigation*

*Difficulty: 1 Easy*

*Gradable: automatic*

36. JM Case Inc. has a market value of $5 million with 500,000 shares outstanding. The book value of its equity is

$1,750,000. If the company repurchases 20 percent of its shares in the stock market, what will be the book value of equity if all else remains the same?

**A.** $750,000

B. $1,250,000

C. $1,000,000

D. $1,400,000

E. $4,000,000

F. None of the options are correct.

JM Case will pay $10 per share for the 100,000 shares (= 0.20 × 500,000) it repurchases. This reduces the book value by $1 million. Assuming all else remains the same, the new book value should be $750,000.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

37. JM Case Inc. has a market value of $5 million with 500,000 shares outstanding. The book value of its equity is

$1,750,000. If the company repurchases 20 percent of its shares in the stock market, there are no taxes or transaction costs, and all else remains the same, what should the market value of the firm be after the repurchase?

A. $1,000,000

B. $1,750,000

C. $3,250,000

**D.** $4,000,000

E. $5,000,000

F. None of the options are correct.

Since nothing else has changed, the market value should fall by exactly the amount of the cash paid in the transaction. The new market value will be $4 million. Another way to think about this is to note that repurchase of the shares will reduce cash by $1 million (or increase liabilities by the same amount if financed with debt), and thus the firm is worth $1 million less to the owners after the repurchase, or $4 million. After repurchasing 100,000 shares (= 0.20 × 500,000), 400,000 shares will be outstanding, and the price per share remains $10 ($4 million/400,000).

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

38. ZZZ Corporation’s income statement shows a provision for income taxes of $65 million in 2017. At the end of 2016, ZZZ’s balance sheet reported income taxes payable of $12 million and deferred taxes of $18 million. At the end of 2017, their balance sheet shows income taxes payable of $15 million and deferred taxes of $17 million. What were ZZZ’s taxes paid in 2017?

A. $61 million

**B.** $63 million

C. $65 million

D. $67 million

E. $69 million

Taxes paid = Provision for income taxes − Increase in taxes payable - Increase in deferred taxes = 65 − 3 + 1 = $63 million

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

39. Which of the following formulas describes the calculation of cash flow from operating activities?

**A.** Net income + Noncash items +/− Changes in current assets and liabilities

B. Net income + Capital expenditures − Dividends paid

C. Net income − Capital expenditures − Dividends paid

D. Net income +/− Changes in current assets and liabilities − Dividends paid

E. Net income + Noncash items − Capital expenditures

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: automatic*

40. The book value of Little Statistic’s total assets is $400,000. Suppose Number Crunching Inc. acquires Little Statistic’s assets for $1 million and finances the purchase by selling $600,000 in new stock, $300,000 in new debt, and reducing cash by $100,000. Describe how the acquisition affects Number Crunching’s balance sheet.

First, let us account for Number Crunching’s $1 million expenditure. Cash will fall $100,000, liabilities will rise

$300,000, and owners’ equity will rise $600,000. Next, let us account for the assets acquired. The accountants will write up the value of fixed assets and possibly inventory to their estimated replacement value; they will then add the difference between the acquisition price and the replacement value of the assets acquired to a goodwill account appearing in the long-term assets section of Number Crunching’s balance sheet; and lastly, they will consolidate the two companies’ balance sheets by adding like accounts together.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: manual*

41. Playdough Products earned net income of $500,000 in 2017. The firm increased its accounts receivable during the year by $220,000. The book value of its assets declined by the year’s depreciation charge, which was $140,000, and the market value of its assets increased by $50,000. Based only on this information, how much cash did Playdough Products generate during the year? Please ignore taxes for this problem.

Playdough Products generated $420,000 of cash during the year. The $500,000 net income ignores the fact that accounts receivable rose $220,000, a use of cash. It also treats $140,000 depreciation as an expense, whereas it is a noncash charge. The $50,000 increase in market value of assets adds to the value of the business, but is not a cash flow. Summary:

|  |  |
| --- | --- |
| Accounting Income | $ 500,000 |
| Depreciation, a non-cash charge | +$ 140,000 |
| Increase in Accounts Receivable | −$ 220,000 |
| Cash generated | $ 420,000 |



*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: manual*

42. During 2017, Lele Design earned net income of $250,000. The firm neither bought nor sold any capital assets. The book value of its assets declined by the year’s depreciation charge of $200,000. The firm’s operating cash flow for the year was $450,000. The market value of its assets increased by $300,000. Based only on this information, what was Lele Design’s economic income for the year? Why is this figure different from its accounting income? Please ignore taxes for this problem.

Lele Design generated economic income equal to $750,000, comprised of $450,000 in operating cash flow ($250,000 net income plus $200,000 depreciation) plus a $300,000 increase in the market value of its assets. The $500,000 difference between economic income and accounting income consists of the $200,000 noncash charge of depreciation, and the $300,000 appreciation in the market value of assets, which accounting income does not include.

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: manual*

43. Identify the sources and uses of cash for Blackhurst Corporation for 2017 based on the following year-end balance sheets.

|  |  |  |  |
| --- | --- | --- | --- |
| ASSETS | 2016 | 2017 |  |
|  |  |  |
| Cash | 40 | 30 |  |
| Accounts receivable | 100 | 150 |  |
| Inventory | 135 | 125 |  |
| Net fixed assets | 200 | 240 |  |
|  | 475 | 545 |  |
| LIABILITIES & EQUITY |  |  |  |
| Bank loan | 40 | 100 |  |
| Long-term debt | 200 | 180 |  |
| Equity | 235 | 265 |  |
|  | 475 | 545 |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ASSETS | 2016 | 2017 | Sources | Uses |  |
|  |  |  |  |  |
| Cash | 40 | 30 | 10 |  |  |
| Accounts receivable | 100 | 150 |  | 50 |  |
| Inventory | 135 | 125 | 10 |  |  |
| Net fixed assets | 200 | 240 |  | 40 |  |
|  | 475 | 545 |  |  |  |
| LIABILITIES & EQUITY |  |  |  |  |  |
| Bank loan | 40 | 100 | 60 |  |  |
| Long-term debt | 200 | 180 |  | 20 |  |
| Equity | 235 | 265 | 30 |  |  |
|  | 475 | 545 | 110 | 110 |  |

*Accessibility: Keyboard Navigation*

*Difficulty: 2 Medium*

*Gradable: manual*

**Chapter 01 Test Bank Summary**

|  |  |
| --- | --- |
| *Category* | *# of Questions* |
| Accessibility: Keyboard Navigation | 43 |
| Difficulty: 1 Easy | 21 |
| Difficulty: 2 Medium | 21 |
| Difficulty: 3 Hard | 1 |
| Gradable: automatic | 39 |
| Gradable: manual | 4 |