ACCOUNTING 203
Chapter 10 Practice Test

True and False Questions

1. A contribution income statement is probably the most effective tool for measuring performance in a cost center.

2. Common fixed costs are defined as those fixed costs that can be identified with a particular segment.

3. ROI and residual income are tools used to evaluate managerial performance in profit centers.

4. Net operating income is income after interest and taxes.

5. A change in sales can affect margin and turnover.

6. A profit center is responsible for generating revenue, but is not responsible for controlling costs.

Multiple Choice Questions

7. Residual income is a better measure for performance evaluation of an investment center manager than return on investment because:

A) the problems associated with measuring the asset base are eliminated.
B) desirable investment decisions will not be rejected by divisions that already have a high ROI.
C) only the gross book value of assets need to be calculated.
D) returns do not increase as assets are depreciated.

8. A company that is seeking to increase ROI should attempt to decrease:

A) sales.
B) turnover.
C) margin.
D) average operating assets.
9. Which of the following would be considered an operating asset in return on investment computations?

A) Land being held for plant expansion.
B) Treasury stock.
C) Accounts receivable.
D) Common stock.

10. Which of the following would be an argument for the use of net book value in the computation of operating assets in return on investment calculations?

A) It allows the manager to replace old, worn-out equipment with a minimum adverse impact on ROI.
B) It allows ROI to decrease over time as assets get older.
C) It is consistent with how plant and equipment items are reported on the balance sheet.
D) It eliminates both age of equipment and method of depreciation as factors in ROI computations.

Use the following to answer questions 11-13

Wagustin Industries is a division of a major corporation. Data concerning the most recent year appears below:

Sales ........................................... $17,000,000
Net operating income ...................... $1,581,000
Average operating assets ................. $5,000,000

11. The division’s margin is closest to:

A) 31.6%.
B) 29.4%.
C) 38.7%.
D) 9.3%

12. The division’s turnover is closest to:

A) 3.40.
B) 10.75.
C) 2.58.
D) 0.32.
13. The division’s return on investment (ROI) is closest to:

A) 24.0%.
B) 31.6%.
C) 3.0%.
D) 7.2%.

Use the following information to answer questions 14-17.

The Reed Division reports the following operating data for the past two years:

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin</td>
<td>16%</td>
<td>?</td>
</tr>
<tr>
<td>Turnover</td>
<td>2.5</td>
<td>2</td>
</tr>
<tr>
<td>Average operating assets</td>
<td>?</td>
<td>$150,000</td>
</tr>
<tr>
<td>Net operating income</td>
<td>$40,000</td>
<td>?</td>
</tr>
<tr>
<td>Stockholders’ equity</td>
<td>$80,000</td>
<td>$125,000</td>
</tr>
<tr>
<td>Sales</td>
<td>?</td>
<td>?</td>
</tr>
</tbody>
</table>

The return on investment at Reed was exactly the same in Year 1 and Year 2.

14. The margin in Year 2 was:
A) 48%.
B) 32%.
C) 20%.
D) 10%.

15. Sales in Year 2 amounted to:
A) $250,000.
B) $300,000.
C) $325,000.
D) $350,000.

16. Average operating assets in Year 1 were:
A) $160,000.
B) $150,000.
C) $125,000.
D) $100,000.

17. Net operating income in Year 2 amounted to:
A) $60,000.
B) $50,000.
C) $40,000.
D) $35,000.
Answers:

True and False

Multiple Choice