The answer to the question is highlighted in red. Explanations are highlighted in green.

6. Depreciation must be considered when evaluating the incremental operating cash flows associated with a capital budgeting project because
   a. it represents a tax-deductible cash expense.
   b. the firm has a cash outflow equal to the depreciation expense each year.
   c. although it is a non-cash expense, depreciation has an impact on the taxes paid by the firm, which is a cash flow.
   d. depreciation is a sunk cost.
   e. None of the above is correct.

Depreciation is a non-cash expense. However, the depreciation expense reduces taxable income, it affects the taxes paid (in cash) by the firm.

RETURN TO THE SAMPLE QUESTIONS