

## Chapter 1– Financial Accounting, 2<sup>nd</sup> edition by Dyckman & Pfeiffer

### Solutions to Practice Quiz

Topic: Financial Accounting

LO: 1

1. Which of the following statements best explains the use of financial accounting information?
- Company managers use financial accounting reports to make decision such as whether to drop or add products.
  - Financial accounting focuses on profitability and financial health of companies.
  - Financial accounting includes proprietary information about the profitability of specific divisions.
  - Company managers use financial accounting reports to make decisions such as whether to continue serving different types of customers.

Answer: B

Rationale: Financial accounting is designed primarily for decision makers outside of the company and focuses on profitability and financial health of companies.

Topic: Accounting Equation & Business Activities

LO: 2

2. Equity, as represented in the accounting equation, would increase as a result of which of the following items?
- Borrowing from a commercial bank
  - Payments of cash to the owners
  - Losses from unprofitable operations of a business
  - Earnings from operating a business

Answer: D

Rationale: Earnings from operating a business increase equity.

Topic: Accounting Equation

LO: 2

3. All of the following are accurate representations of the accounting equation except:
- $\text{Assets} - \text{Equity} = \text{Liabilities}$
  - $\text{Investing} - \text{Creditor Financing} = \text{Owner Financing}$
  - $\text{Assets} + \text{Liabilities} = \text{Equity}$
  - $\text{Owner Financing} + \text{Creditor Financing} = \text{Investing}$

Answer: C

Rationale: The equality of the accounting equation can be represented as either of the following equations or their derivatives ( $\text{Assets} = \text{Liabilities} + \text{Equity}$ ;  $\text{Investing} = \text{Creditor Financing} + \text{Owner Financing}$ ).

Topic: Financial Statement Linkages

LO: 3

4. Which of the following represents a key financial statement linkage?

- a. The statement of cash flows links the beginning and ending contributed capital in the statement of stockholders' equity.
- b. The balance sheet links the beginning and ending net income in the statement of cash flows.
- c. The income statement links the beginning and ending increase in cash.
- d. None of these represents a key financial statement linkage.

Answer: D

Rationale: The three key financial statement linkages include: (1) the statement of cash flows links the beginning and ending cash in the balance sheet; (2) the income statement links the beginning and ending retained earnings in the statement of stockholders' equity; and (3) the statement of stockholders' equity links the beginning and ending equity in the balance sheet.

Topic: Accounting Regulation and Oversight

LO: 4

5. Which of the following established the Public Company Accounting Oversight Board (PCAOB)?

- a. FASB
- b. AICPA
- c. SOX
- d. GAAP

Answer: C

Rationale: The Sarbanes-Oxley Act (SOX) established the PCAOB.

Topic: Credit Risk Analysis

LO: 5

6. Below is information for Companies A, B, C, and D.

(in \$millions)	Company A	Company B	Company C	Company D
Net income (loss), 12/31/11	22.3	157.6	83.7	200.8
Stockholders' Equity, 12/31/10	131.6	333.9	407.1	978.9
Stockholders' Equity, 12/31/11	175.8	446.7	338.9	967.8
Total liabilities, 12/31/11	257.9	667.1	786.3	1,111.4

Based on this information and using the debt-to-equity ratio to evaluate, which company is the least risky in terms of long-term solvency in 2011?

- a. Company A
- b. Company B
- c. Company C
- d. Company D

Answer: D

Rationale: Company A: **Debt-to-Equity = \$257.9 / \$175.8 = 1.47**  
Company B: **Debt-to-Equity = \$667.1 / \$446.7 = 1.49**  
Company C: **Debt-to-Equity = \$786.3 / \$338.9 = 2.32**  
Company D: **Debt-to-Equity = \$1,111.4 / \$967.8 = 1.15**

Topic: Profitability Analysis

LO: 5

7. Below is information for Companies A, B, C, and D.

	Company A	Company B	Company C	Company D
Net income (loss), 12/31/11	22.3	157.6	83.7	200.8
Stockholders' Equity, 12/31/10	131.6	333.9	407.1	978.9
Stockholders' Equity, 12/31/11	175.8	446.7	338.9	967.8
Total liabilities, 12/31/11	257.9	667.1	786.3	1,111.4

Based on this information and using the return on equity ratio to evaluate, which company earned a higher rate of return for its shareholders in 2011?

- a. Company A
- b. Company B
- c. Company C
- d. Company D

Answer: B

Rationale: Company A:  $ROE = \$22.3 / [(\$131.6 + \$175.8)/2] = \underline{14.5\%}$   
Company B:  $ROE = \$157.6 / [(\$333.9 + \$446.7)/2] = \underline{40.4\%}$   
Company C:  $ROE = \$83.7 / [(\$407.1 + \$338.9)/2] = \underline{22.4\%}$   
Company D:  $ROE = \$200.8 / [(\$978.9 + \$967.8)/2] = \underline{20.6\%}$

Topic: Conceptual Framework

LO: 6

8. Which of the following qualitative characteristics of accounting best enables users to identify similarities and differences between financial data for two companies in the same industry?

- a. Relevance
- b. Consistency
- c. Reliability
- d. Comparability

Answer: D

Rationale: One of the consequences of comparability is that firms in the same industry use the same or similar reporting techniques.

Topic: Financial Statements

LO: 3

9. During the current year, the liabilities of Markham Company decreased by \$60,000 and equity increased by \$95,000. Based on this information, which of the following is correct?

- a. Assets at the end of the year totaled \$35,000.
- b. Assets decreased during the year by \$155,000.
- c. Assets at the end of the year totaled \$155,000.
- d. Assets increased during the year by \$35,000.

Answer: D

Rationale:  $\$95,000 - 60,000 = \$35,000$  increase on both sides of the balance sheet

Topic: Financial Statements

LO: 3

10. Below are several line items and account titles.

- I. Net income
- II. Cash asset
- III. Retained earnings
- IV. Expenses
- V. Noncash assets

Which of these would you most likely find in the statement of stockholders' equity?

- a. I, III, and V
- b. II and V
- c. I and III
- d. None of these.

Answer: C

Rationale: Line items typically found in the statement of stockholders' equity include contributed capital from stock issuance and retained earnings, which show the effects of net income and dividends.