

## Chapter 1– Financial Accounting, 5<sup>th</sup> Edition by Dyckman, Hanlon, Magee, & Pfeiffer

### Solutions to Practice Quiz

#### Topic: Financial Accounting

##### LO: 1

1. Which of the following statements best explains the use of financial accounting information?
  - a. Company managers use financial accounting reports to make decision such as whether to drop or add products.
  - b. Financial accounting focuses on profitability and financial health of companies.
  - c. Financial accounting includes proprietary information about the profitability of specific divisions.
  - d. 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?
  - a. Borrowing from a commercial bank
  - b. Payments of cash to the owners
  - c. Losses from unprofitable operations of a business
  - d. 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:
  - a.  $\text{Assets} - \text{Equity} = \text{Liabilities}$
  - b.  $\text{Investing} - \text{Creditor Financing} = \text{Owner Financing}$
  - c.  $\text{Assets} + \text{Liabilities} = \text{Equity}$
  - d.  $\text{Owner Financing} + \text{Creditor Financing} = \text{Investing}$

*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), 12/31/16	22.3	157.6	83.7	200.8
Stockholders' Equity, 12/31/15	131.6	333.9	407.1	978.9
Stockholders' Equity, 12/31/16	175.8	446.7	338.9	967.8
Total liabilities, 12/31/16	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 2016?

- Company A
- Company B
- Company C
- Company D

*Answer: d*

Rationale: Company A: **Debt-to-Equity** =  $\$257.9 / \$175.8 = \underline{1.47}$

Company B: **Debt-to-Equity** =  $\$667.1 / \$446.7 = \underline{1.49}$

Company C: **Debt-to-Equity** =  $\$786.3 / \$338.9 = \underline{2.32}$

Company D: **Debt-to-Equity** =  $\$1,111.4 / \$967.8 = \underline{1.15}$

**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), 12/31/16	22.3	157.6	83.7	200.8
Stockholders' Equity, 12/31/15	131.6	333.9	407.1	978.9
Stockholders' Equity, 12/31/16	175.8	446.7	338.9	967.8
Total liabilities, 12/31/16	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 2016?

- Company A
- Company B
- Company C
- 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?
- Relevance
  - Consistency
  - Reliability
  - 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?
- Assets at the end of the year totaled \$35,000.
  - Assets decreased during the year by \$155,000.
  - Assets at the end of the year totaled \$155,000.
  - 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.

- Net income
- Cash asset
- Retained earnings
- Expenses
- Noncash assets

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

- I, III, and V
- II and V
- I and III
- 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.