

Solutions to Practice Quiz

Chapter 1 – Economic Environment of Accounting Information

Multiple Choice Questions. Identify the answer that BEST completes the statement or answers the question.

1. For what reason did generally-accepted accounting principles arise?
 - a. To prevent financial debacles such as Enron, WorldCom, and Global Crossing.
 - b. To benefit capital market participants.
 - c. To facilitate the proper preparation of income tax returns.
 - d. To assess financial risk that may result from a company not paying its debt when due.

Answer: b

2. On which of the following financial statements will you most likely find the amount of cash generated from a company's core business operations?
 - a. Statement of cash flow
 - b. Income statement
 - c. Balance sheet
 - d. Statement of shareholders' equity

Answer: a

3. The following information was provided by Jones& Sons Inc. for its year ending December 31:

| | |
|----------------------------------|--------------|
| Economic resources at year-end | \$24,000,000 |
| Net income for the year | 2,500,000 |
| Shareholders' equity at year-end | 17,500,000 |

How much does Smith & Sons owe its creditors as of December 31?

- a. \$ 6,500,000
- b. \$20,000,000
- c. \$24,500,000
- d. \$ 7,000,000

Answer: a

Rationale: (\$24,000,000 – \$17,500,000)

4. What information is found on the balance sheet?
 - a. Results of recurring operations for the period.
 - b. Reasons why assets are greater at the end of the year compared to the beginning of the year.
 - c. The financial position of a company as of the balance sheet date.
 - d. The profitability of a company during the period.

Answer: c

5. Brown & Co. reported the following amounts on its balance sheet (in thousands) for Year 1 and Year 2:

| Year End | Assets | Liabilities | Shareholders' Equity |
|----------|----------|-------------|----------------------|
| Year 1 | \$40,000 | \$25,000 | \$15,000 |
| Year 2 | 71,000 | 28,000 | 43,000 |

No dividends were declared and no additional investments of capital were made in the company during Year 2. What is the company's net income for Year 2?

- a. \$ 3,000,000
- b. \$28,000,000
- c. \$15,000,000
- d. Not enough information is provided to determine the answer.

Answer: b

Rationale: (\$43,000,000 – \$15,000,000)

6. Jones & Sons reported the following amounts on its statement of cash flow for the year:

| | |
|---|-------------|
| Net cash provided by operating activities | \$2,800,000 |
| Net cash provided by financing activities | 2,400,000 |
| Net cash flow for the year | 7,200,000 |
| Retained earnings at December 31 | 900,000 |

How much is the company's net cash provided by investing activities?

- a. \$2,600,000
- b. \$2,500,000
- c. \$3,300,000
- d. \$2,000,000

Answer: d

Rationale: (\$7,200,000 – \$2,800,000 – \$2,400,000)

7. Which of the financial statements provides amounts as of a particular point in time?
- Income statement
 - Statement of shareholders' equity
 - Statement of cash flow
 - Balance sheet
 - All of the statements provide amounts as of a point in time.

Answer: d

8. The management of Navistar Corporation determined that any asset whose value equals or exceeds five percent of total assets should be reported on its balance sheet. What accounting concept has Navistar applied?
- Going concern
 - Reliability
 - Relevance
 - Materiality

Answer: d

9. Which of the following statements is *true*?
- All of a company's identifiable assets and liabilities appear on the balance sheet.
 - The financial statements articulate with each other.
 - The basic financial statements reflect a complete, accurate, portrayal of the financial performance of a company.
 - The difference between a company's assets and liabilities should be equal to the market value of the shares owned by investors.

Answer: b

10. The Clarion Company reported total retained earnings at December 31, Year 2 of \$179,000. It provided the following information for Year 1 and Year 2:

| | Year 2 | Year 1 |
|-------------------------------|-----------|-----------|
| Retained earnings (beginning) | \$255,000 | \$125,000 |
| Revenues | 882,000 | 870,000 |
| Expenses | 740,000 | 625,000 |
| Dividends | ? | 105,000 |

How much dividends did the company pay in Year 2?

- \$240,000
- \$152,000
- \$218,000
- \$138,000

Answer: c

Rationale: $(\$255,000 + [\$882,000 - \$740,000] - \$179,000)$