Financial & Managerial Accounting for Decision Makers, 3rd Edition by Dyckman, Hanlon, Magee, Pfeiffer, Hartgraves, and Morse

Chapter 1—Introducing Financial Accounting

Solutions to Practice Quiz

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.

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.

3. All of the following are accurate representations of the accounting equation except:

a. Assets – Equity = Liabilities
b. Investing – Creditor Financing = Owner Financing
c. Assets + Liabilities = Equity
d. Owner Financing + Creditor Financing = Investing

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

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.

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.

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?

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**

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?

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] = 14.5%**
Company B: **ROE = $157.6 / [($333.9 + $446.7)/2] = 40.4%**
Company C: **ROE = $83.7 / [($407.1 + $338.9)/2] = 22.4%**
Company D: **ROE = $200.8 / [($978.9 + $967.8)/2] = 20.6%**

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.

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

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.