



DSST Prep Financial Accounting

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1. Which of the following is classified as a current asset on the balance sheet?

- A. Patents
- B. Equipment
- C. Long-term investments
- D. Accounts receivable

2. On the balance sheet, total assets must equal

- A. Total revenues minus total expenses
- B. Total liabilities minus stockholders' equity
- C. Total liabilities plus stockholders' equity
- D. Net income plus retained earnings

3. Which financial statement shows a company's financial position at a specific point in time?

- A. Income statement
- B. Balance sheet
- C. Statement of cash flows
- D. Statement of retained earnings

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4. Net income from the income statement flows directly into which other financial statement?

- A. Statement of retained earnings
- B. Balance sheet only
- C. Statement of cash flows only
- D. Pro forma balance sheet



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5. The current ratio is calculated as

- A. Cash divided by current liabilities
- B. Current liabilities divided by current assets
- C. Total assets divided by total liabilities
- D. Current assets divided by current liabilities

6. Which of the following ratios is used to measure a company's liquidity?

- A. Return on assets
- B. Debt-to-equity ratio
- C. Quick ratio
- D. Gross profit margin

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7. The statement of cash flows is divided into which three main sections?

- A. Current, non-current, and equity activities
- B. Operating, investing, and financing activities
- C. Revenue, expense, and net income activities
- D. Cash, receivables, and inventory activities

8. Under the indirect method of preparing the statement of cash flows, depreciation expense is

- A. Added back to net income
- B. Subtracted from net income
- C. Shown as a financing activity
- D. Shown as an investing activity

9. The debt-to-equity ratio is used to measure a company's

- A. Market value
- B. Liquidity
- C. Profitability
- D. Solvency

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10. Which of the following is an example of a profitability ratio?

- A. Debt ratio
- B. Current ratio
- C. Return on equity
- D. Times interest earned

11. Gross profit is calculated as

- A. Sales revenue minus operating expenses
- B. Sales revenue minus cost of goods sold
- C. Operating income minus interest expense
- D. Total revenue minus total expenses

12. The DuPont analysis decomposes return on equity (ROE) into which three components?

- A. Profit margin, asset turnover, and equity multiplier
- B. Current ratio, quick ratio, and cash ratio
- C. Gross margin, operating margin, and net margin
- D. Debt ratio, equity ratio, and leverage ratio

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13. If a company's marginal tax rate is 35% and its average tax rate is 28%, which rate should be used for evaluating a new project?

- A. The sum of both rates
- B. The average tax rate of 28%
- C. The difference of 7%
- D. The marginal tax rate of 35%

14. Which of the following appears on both the income statement and the statement of cash flows?

- A. Purchase of equipment
- B. Dividends paid
- C. Interest expense
- D. Issuance of stock



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15. The times interest earned ratio measures a company's ability to

- A. Pay its current liabilities
- B. Meet its interest obligations
- C. Generate profit from sales
- D. Convert assets into cash

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16. Inventory turnover ratio is calculated as

- A. Cost of goods sold divided by average inventory
- B. Sales divided by average inventory
- C. Average inventory divided by cost of goods sold
- D. Ending inventory divided by beginning inventory

17. Pro forma financial statements are used primarily for

- A. Recording actual past transactions
- B. Historical performance analysis only
- C. Tax reporting to the IRS
- D. Financial planning and forecasting

18. On the statement of cash flows, the purchase of treasury stock would be classified as a

- A. Investing activity
- B. Operating activity
- C. Financing activity
- D. Non-cash activity

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19. The asset turnover ratio measures

- A. How quickly assets can be converted to cash
- B. How efficiently assets are used to generate sales
- C. The profitability of the company's assets
- D. The liquidity position of the company



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20. Which of the following would cause total stockholders' equity to increase?

- A. Net income for the period
- B. Payment of cash dividends
- C. Purchase of treasury stock
- D. Payment of accounts payable

21. The cash conversion cycle is calculated as:

- A. Operating cycle plus accounts payable period
- B. Inventory period plus accounts payable period
- C. Accounts receivable period minus inventory period
- D. Operating cycle minus accounts payable period

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22. A firm has an average collection period of 40 days, an average inventory period of 60 days, and an average payment period of 35 days. What is the firm's cash conversion cycle?

- A. 25 days
- B. 135 days
- C. 65 days
- D. 100 days

23. Which of the following represents a use of cash in working capital management?

- A. An increase in accounts payable
- B. An increase in accounts receivable
- C. A decrease in inventory
- D. An increase in accrued expenses

24. A company offers credit terms of 2/10, net 30. What is the approximate annualized cost of not taking the discount?

- A. 37.2%
- B. 2.0%
- C. 24.0%
- D. 18.3%

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25. Which of the following is NOT a component of the operating cycle?

- A. Average age of inventory
- B. Inventory period
- C. Accounts receivable period
- D. Accounts payable period

26. A firm adopts a more aggressive working capital policy. Which of the following is most likely to occur?

- A. Increased liquidity
- B. Higher levels of current assets relative to sales
- C. Lower levels of current assets relative to sales
- D. Lower short-term debt usage

27. The quick ratio differs from the current ratio in that it:

- A. Includes only cash and marketable securities
- B. Excludes inventory from current assets
- C. Uses total assets instead of current assets
- D. Excludes accounts payable from current liabilities

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28. Which short-term financing source typically has the lowest explicit cost?

- A. Accrued expenses
- B. Commercial paper
- C. Line of credit
- D. Factoring of receivables

29. A company is preparing a cash budget. Which of the following would appear as a cash inflow?

- A. Depreciation expense
- B. Purchase of inventory
- C. Payment of accounts payable
- D. Collection of accounts receivable



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30. Float refers to the difference between:

- A. Cash receipts and cash disbursements
- B. Current assets and current liabilities
- C. The firm's book balance and the bank's available balance
- D. Accounts receivable and accounts payable



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Answer Key & Explanations

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1. D — Accounts receivable

Accounts receivable represents amounts owed to the company by customers and is expected to be collected within one year, making it a current asset.

2. C — Total liabilities plus stockholders' equity

The fundamental accounting equation states that $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$. This equation must always balance.

3. B — Balance sheet

The balance sheet presents a snapshot of assets, liabilities, and equity at a specific date, showing the company's financial position at that moment.

4. A — Statement of retained earnings

Net income from the income statement is added to beginning retained earnings on the statement of retained earnings (or statement of owner's equity) to calculate ending retained earnings.

5. D — Current assets divided by current liabilities

The current ratio is a liquidity measure calculated by dividing current assets by current liabilities. It indicates the company's ability to pay short-term obligations.

6. C — Quick ratio

The quick ratio (acid-test ratio) measures a company's ability to meet short-term obligations using its most liquid assets, making it a liquidity ratio.

7. B — Operating, investing, and financing activities

The statement of cash flows categorizes cash flows into operating activities (day-to-day business), investing activities (long-term assets), and financing activities (debt and equity).

8. A — Added back to net income

Depreciation is a non-cash expense that reduced net income but did not use cash. Therefore, it is added back to net income to calculate cash from operating activities.

9. D — Solvency

The debt-to-equity ratio compares total liabilities to stockholders' equity, measuring the degree of financial leverage and long-term solvency of the company.

10. C — Return on equity

Return on equity (ROE) measures how effectively a company generates profit from shareholders' investments, making it a key profitability ratio.

11. B — Sales revenue minus cost of goods sold

Gross profit represents the difference between sales revenue and the direct cost of producing goods sold (cost of goods sold). It appears on the income statement.



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12. A — Profit margin, asset turnover, and equity multiplier

The DuPont formula breaks ROE into profit margin (profitability), total asset turnover (efficiency), and equity multiplier (leverage): $ROE = \text{Profit Margin} \times \text{Asset Turnover} \times \text{Equity Multiplier}$.

13. D — The marginal tax rate of 35%

The marginal tax rate should be used for decision making because it represents the tax rate applied to the next dollar of income, which is relevant for evaluating incremental projects.

14. C — Interest expense

Interest expense appears as an expense on the income statement and is also part of the operating activities section of the statement of cash flows (under the indirect method).

15. B — Meet its interest obligations

The times interest earned ratio (EBIT divided by interest expense) measures how many times a company can cover its interest obligations with operating income, indicating solvency.

16. A — Cost of goods sold divided by average inventory

Inventory turnover measures how many times inventory is sold and replaced during a period. It is calculated by dividing cost of goods sold by average inventory.

17. D — Financial planning and forecasting

Pro forma statements are projected financial statements used for planning and forecasting future financial performance based on assumptions about future business conditions.

18. C — Financing activity

Treasury stock purchases involve the company buying back its own shares, which is a transaction with owners and therefore classified as a financing activity.

19. B — How efficiently assets are used to generate sales

Asset turnover (Sales divided by Total Assets) measures how efficiently a company uses its assets to generate sales revenue. Higher turnover indicates better asset utilization.

20. A — Net income for the period

Net income increases retained earnings, which is a component of stockholders' equity. Profitable operations increase the equity of the company.

21. D — Operating cycle minus accounts payable period

The cash conversion cycle equals the operating cycle minus the accounts payable period. It represents the time from when cash is paid for inventory until cash is collected from customers.

22. C — 65 days

Cash conversion cycle = Inventory period + Collection period - Payment period = $60 + 40 - 35 = 65$ days.

23. B — An increase in accounts receivable

An increase in accounts receivable means the firm has extended more credit to customers, tying up cash in receivables. This is a use of cash.

24. A — 37.2%

The discount is 2% for paying 20 days early (30-10). Annualized cost = $(2/98) \times (365/20) =$ approximately 37.2%.



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25. D — Accounts payable period

The operating cycle includes the inventory period and accounts receivable period. The accounts payable period is not part of the operating cycle; it is subtracted from the operating cycle to calculate the cash conversion cycle.

26. C — Lower levels of current assets relative to sales

An aggressive working capital policy involves maintaining lower levels of current assets relative to sales, which increases risk but may improve returns.

27. B — Excludes inventory from current assets

The quick ratio (acid-test ratio) excludes inventory from current assets because inventory is less liquid than other current assets like cash and receivables.

28. A — Accrued expenses

Accrued expenses (wages, taxes) represent spontaneous financing with no explicit interest cost, making them the lowest-cost source of short-term financing.

29. D — Collection of accounts receivable

Collection of accounts receivable converts credit sales into cash, representing a cash inflow in the cash budget.

30. C — The firm's book balance and the bank's available balance

Float is the difference between the cash balance shown on a firm's books and the cash balance shown on the bank's books, arising from delays in processing checks and deposits.



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