Financial Reporting and Analysis: An Introduction

Test ID: 7659214

Question #1 of 76

Question ID: 413992

Which of the following is *least likely* to be considered a role of financial statement analysis?

✗ **A)** **Determining whether to invest in the company's securities.**

✓ **B)** Assessing the management skill of the company's executives.

✗ **C)** To make economic decisions.

Explanation

The role of financial statement analysis is to use the information in a company's financial statements, along with other relevant information, to make economic decisions. Examples of such decisions include whether to invest in the company's securities or recommend them to other investors, or whether to extend trade or bank credit to the company. Although the financial statements might provide indirect evidence about the management skill of the company's executives, that is not generally considered the role of financial statement analysis.

Question #2 of 76

Question ID: 485770

A company collects cash from a customer to settle an account receivable. What effect does this transaction have on the company's total assets and total shareholders' equity?

	Assets	Equity
✗ **A)**	**Increase**	**Increase**
✗ **B)**	No effect	Increase
✓ **C)**	No effect	No effect

Explanation

Collecting amounts due from customers has no effect on the accounting equation because it increases one asset (cash) and decreases another asset (accounts receivable). Equity increases in the period when a company sells an item on credit and delivers it to a customer. Equity does not change when the firm later collects the cash.

Question #3 of 76

Question ID: 413996

The Management Discussion and Analysis (MD&A) portion of the financial statements:

✗ **A)** **is not required by the SEC.**

✓ **B)** includes such items as discontinued operations, extraordinary items, and other unusual or infrequent events.

✗ **C)** includes audited disclosures that help explain the information summarized in the financial statements.

Explanation

The MD&A provides an assessment of the financial performance and condition of the company from the perspective of the company and is required by the SEC. It includes many areas including such items as discontinued operations, extraordinary items, and other unusual or infrequent events. The MD&A is typically not audited.

Question #4 of 76

Question ID: 414013

In the expanded form of the accounting equation, assets equal liabilities plus contributed capital plus:

✗ **A)** **ending retained earnings minus beginning retained earnings.**

✗ **B)** beginning retained earnings plus revenue minus expenses.

✓ **C)** ending retained earnings.

Explanation

Equity equals contributed capital plus ending retained earnings. Ending retained earnings equal beginning retained earnings plus revenue minus expenses minus dividends paid.

Question #5 of 76

Question ID: 413993

According to the IASB, which of the following *least* accurately describes financial reporting? Financial reporting:

✗ **A)** **provides information about changes in financial position of an entity.**

✓ **B)** uses the information in a company's financial statements to make economic decisions.

✗ **C)** is useful to a wide range of users.

Explanation

The role of financial reporting is described by the International Accounting Standards Board (IASB) in its "Framework for the Preparation and Presentation of Financial Statements":

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

Using the information in a company's financial statements to make economic decisions is financial analysis, not financial reporting.

Question #6 of 76

Question ID: 414025

Alpha Company reported the following financial statement information:

December 31, 2006:

Assets	$70,000

Liabilities	45,000

December 31, 2007:

Assets	82,000
Liabilities	55,000

During 2007:

Stockholder investments	3,000
Net income	?
Dividends	6,000

Calculate Alpha's net income for the year ended December 31, 2007 and the *change* in stockholders' equity for the year ended December 31, 2007.

	Net income	Change in stockholders' equity
✗ A)	**$5,000**	**$2,000 decrease**
✗ B)	($3,000)	$2,000 increase
✓ C)	$5,000	$2,000 increase

Explanation

Stockholders' equity, as of December 31, 2006, was $25,000 ($70,000 assets - $45,000 liabilities) and stockholders' equity, as of December 31, 2007, was $27,000 ($82,000 assets - $55,000 liabilities). Stockholders' equity increased $2,000 during 2007. Net income for 2007 was $5,000 ($27,000 ending equity + $6,000 dividends - $3,000 stockholder investments - $25,000 beginning equity).

Question #7 of 76

Question ID: 414014

What is the fundamental balance sheet equation?

✓ A) **Assets = Liabilities + Stockholders' Equity (A = L + E).**

✗ B) Liabilities = Assets + Stockholders' Equity (L = A + E).

✗ C) Assets = Stockholders' Equity - Liabilities (A = E - L).

Explanation

The fundamental balance sheet equation is Assets = Liabilities + Stockholders' Equity (A = L + E). This is the fundamental accounting relationship that sets the basis for recording all financial transactions.

Question #8 of 76

Question ID: 414029

Prema Singh is the bookkeeper for Octabius Industries. Singh has been asked by the CFO of Octabius to review all purchases that occurred between February 1 and February 8 to investigate an error on the receiving dock. Singh will *most likely* look at the:

✗ **A)** **initial trial balance.**

✗ **B)** general ledger.

✓ **C)** general journal.

Explanation

Journal entries record every transaction, showing which accounts are changed by what amounts. A listing of all the journal entries in order by date is called the "general journal."

Question #9 of 76

Question ID: 414023

Beta Company reported the following financial statement information:

December 31, 2006:	
Assets	$58,000
Liabilities	28,000
December 31, 2007:	
Assets	?
Liabilities	38,000
During 2007:	
Stockholder investments	15,500
Net income	18,000
Dividends	7,750

Calculate Beta's total assets and stockholders' equity as of December 31, 2007.

	Total assets	Stockholders' equity
✗ **A)**	**$93,750**	**$30,000**
✓ **B)**	$93,750	$55,750
✗ **C)**	$79,250	$55,750

Explanation

Stockholders' equity, as of December 31, 2006, was $30,000 ($58,000 assets - $28,000 liabilities) and stockholders' equity, as of December 31, 2007, was $55,750 ($30,000 beginning equity + $15,500 stockholder investments + $18,000 net income - $7,750 dividends). Total assets, as of December 31, 2007, are $93,750 ($38,000 liabilities + $55,570 stockholders' equity).

Question #10 of 76

Question ID: 414020

An accounting entry that updates the historical cost of an asset to current market levels is *best* described as:

✗ **A)** **a contra account.**

✓ **B)** a valuation adjustment.

✗ **C)** accumulated depreciation.

Explanation

In some cases, accounting standards require balance sheet values of certain assets to reflect their current market values. Accounting entries that update these assets' values from their historical cost are called valuation adjustments. To keep the accounting equation in balance, changes in asset values are also changes in owners' equity, through gains or losses on the income statement or in "other comprehensive income."

Question #11 of 76

Question ID: 485773

Which of the following financial reporting choices is permitted under IFRS but not under U.S. GAAP?

✗ **A)** **Netting deferred tax assets with deferred tax liabilities.**

✗ **B)** Excluding actuarial gains and losses from balance sheet pension items.

✓ **C)** Revaluing plant and equipment upward.

Explanation

Upward revaluation of long-lived assets is permitted under IFRS. Under U.S. GAAP, most assets (other than certain financial instruments) may not be revalued upward. Neither netting deferred tax assets with deferred tax liabilities nor excluding actuarial gains and losses from balance sheet pension items is permitted under IFRS or U.S. GAAP.

Question #12 of 76

Question ID: 414021

Accruals are *best* described as requiring an accounting entry:

✓ **A)** **when the earliest event in a transaction occurs.**

✗ **B)** only when a good or service has been provided.

✗ **C)** when an expense has been incurred.

Explanation

Accruals require an accounting entry when the earliest event occurs (paying or receiving cash, providing a good or service, or incurring an expense) and one or more offsetting entries as the exchange is completed.

Question #13 of 76

Question ID: 413995

Which of the following statements represents information at a specific point in time?

- ✗ **A)** **The income statement and the balance sheet.**
- ✓ **B)** The balance sheet.
- ✗ **C)** The income statement.

Explanation

The balance sheet represents information at a specific point in time. The income statement represents information over a period of time.

Question #14 of 76

Question ID: 414003

Which of the following statements about proxy statements is *least* accurate? Proxy statements are:

- ✗ **A)** **a good source of information about the qualifications of board members and management.**
- ✗ **B)** available on the EDGAR web site.
- ✓ **C)** not filed with the SEC.

Explanation

Proxy statements are issued to shareholders when there are matters that require a shareholder vote. These statements, which are also filed with the SEC and available from EDGAR, are a good source of information about the election of (and qualifications of) board members, compensation, management qualifications, and the issuance of stock options.

Question #15 of 76

Question ID: 414039

When a publicly traded U.S. company prepares a proxy statement for its shareholders prior to the annual meeting or other shareholder vote, it also files the statement with the SEC as Form:

- ✗ **A)** **144.**
- ✓ **B)** DEF-14A.
- ✗ **C)** 8-K.

Explanation

Form DEF-14A: When a company prepares a proxy statement for its shareholders prior to the annual meeting or other shareholder vote, it also files the statement with the SEC as Form DEF-14A.
Form 8-K: Companies must file this form to disclose material events including significant asset acquisitions and disposals, changes in management or corporate governance, or matters related to its accountants, financial statements, or the markets on which its securities trade.
Form 144: A company can issue securities to certain qualified buyers without registering the securities with the SEC, but must notify the SEC that it intends to do so.

Question #16 of 76

Question ID: 414004

Which of the following is an analyst *least likely* to rely on as objective information to include in a company analysis?

✗ **A)** **Government agency statistical data on the economy and the company's industry.**

✗ **B)** Proxy statements.

✓ **C)** Corporate press releases.

Explanation

Corporate reports and press releases are written by management and are often viewed as public relations or sales materials. An analyst should review information on the economy and the company's industry and compare the company to its competitors. This information can be acquired from sources such as trade journals, statistical reporting services, and government agencies. Securities and Exchange Commission (SEC) filings include Form 8-K, which a company must file to report events such as acquisitions and disposals of major assets or changes in its management or corporate governance and proxy statements, which are a good source of information about the election of (and qualifications of) board members, compensation, management qualifications, and the issuance of stock options.

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Question ID: 414024

Wichita Corporation reported the following balances as of December 31, 2007:

Cash	$?
Accounts payable	16,000
Accounts receivable	58,000
Additional paid-in capital	42,000
Common stock	19,600
Inventory	12,000
Plant and equipment	26,800
Notes payable	20,000
Retained earnings	32,000

Calculate Wichita's cash and total assets as of December 31, 2007 based only on these entries.

	Cash	Total assets
✓ **A)**	**$32,800**	**$129,600**
✗ **B)**	$32,800	$113,600
✗ **C)**	$16,000	$129,600

Explanation

Liabilities plus equity are equal to $129,600 ($16,000 accounts payable + $20,000 notes payable + $19,600 common stock +

$42,000 additional paid-in capital + $32,000 retained earnings). Since assets must equal liabilities plus equity, cash must equal $32,800 ($129,600 total assets - $58,000 accounts receivable - $12,000 inventory - $26,800 plant and equipment).

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Question ID: 414056

A firm engages in a new type of financial transaction that has a material effect on its earnings. An analyst should *most likely* be suspicious of the new transaction if:

✗ **A)** **the transaction is not governed by existing regulations.**

✗ **B)** no accounting standard exists that applies to the transaction.

✓ **C)** management has not explained its business purpose.

Explanation

New types of transactions may emerge that are not covered by existing accounting standards or regulations. Analysts should obtain information from a firm's management about the economic substance of such transactions to ensure that they serve a business purpose and have not been created primarily to manipulate the firm's financial statements.

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Question ID: 414031

Reading the footnotes to a company's financial statements and the Management Discussion & Analysis is *least likely* to help an analyst determine:

✗ **A)** **how well the financial statements reflect the company's true performance.**

✗ **B)** the various accruals, adjustments and assumptions that went into the financial statements.

✓ **C)** the detailed information that underlies the company's accounting system.

Explanation

An analyst doesn't have access to the detailed information that flows through a company's accounting system, but only sees its end product, the financial statements. The analyst needs to understand the various accruals, adjustments, and management assumptions that went into the financial statements. Much of this is often explained in the footnotes to the statements and in Management's Discussion and Analysis, which is why it is crucial for an analyst to review these parts of the presentation. With this information, the analyst can better judge how well the financial statements reflect the company's true performance, and in what ways he needs to adjust the data for his own analysis.

Question #20 of 76

Question ID: 414050

Which of the following financial reporting choices is permitted under IFRS but not under U.S. GAAP?

✗ **A)** **Netting deferred tax assets with deferred tax liabilities.**

✓ **B)** Revaluing plant and equipment upward.

✗ **C)** Excluding actuarial gains and losses from balance sheet pension items.

Explanation

Upward revaluation of long-lived assets is permitted under IFRS. Under U.S. GAAP, most assets (other than certain financial instruments) may not be revalued upward. Neither netting deferred tax assets with deferred tax liabilities nor excluding actuarial gains and losses from balance sheet pension items is permitted under IFRS or U.S. GAAP.

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Question ID: 460643

Information about a company's financial position at a point in time is *most likely* found in the:

✗ **A)** **income statement.**

✓ **B)** balance sheet.

✗ **C)** cash flow statement.

Explanation

The balance sheet reports the company's financial position at a point in time. In contrast, the income statement reports on financial performance over a period of time and the cash flow statement reports a company's cash receipts and payments over a period of time.

Question #22 of 76

Question ID: 414010

Allowance for bad debts and investment in affiliates are *most likely* to be shown as what types of accounts?

	Allowance for bad debts	Investment in affiliates
✗ **A)**	**Liabilities**	**Asset**
✓ **B)**	Contra-asset	Asset
✗ **C)**	Contra-asset	Liabilities

Explanation

Allowance for bad debts is a contra-asset account to accounts receivable. Investments in affiliates are considered assets.

Question #23 of 76

Question ID: 414053

Characteristics of a coherent financial reporting framework are *best* described as:

✗ **A)** **materiality, comprehensiveness, and aggregation.**

✗ **B)** consistency, materiality, and transparency.

✓ **C)** transparency, consistency, and comprehensiveness.

Explanation

The three characteristics of a coherent financial reporting framework are transparency, comprehensiveness, and consistency. Materiality and aggregation are two of the features for preparing financial statements listed in International Accounting

Standard No. 1.

Question #24 of 76

Question ID: 414001

Which of the following would NOT require an explanatory paragraph added to the auditors' report?

✓ **A) Statements that the financial information was prepared according to GAAP.**

✗ **B)** Doubt regarding the "going concern" assumption.

✗ **C)** Uncertainty due to litigation.

Explanation

The statements that the financial information was prepared according to GAAP should be included in the regular part of the auditors' report and not as an explanatory paragraph. The other information would be contained in explanatory paragraphs added to the auditors' report.

Question #25 of 76

Question ID: 414011

Accumulated depreciation and treasury stock are *most likely* to be shown as what types of accounts?

	Accumulated depreciation	Treasury stock
✗ A)	**Liability**	**Equity**
✓ B)	Contra-asset	Contra-equity
✗ C)	Contra-asset	Equity

Explanation

Accumulated depreciation is a contra-asset account to the asset account property, plant & equipment. Treasury stock is a contra-equity account to common stock or additional paid-in capital.

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Question ID: 414038

Professional organizations of accountants and auditors that establish financial reporting standards are called:

✗ **A) Regulatory authorities.**

✗ **B)** International organizations of securities commissions.

✓ **C)** Standard setting bodies.

Explanation

Standard-setting bodies are professional organizations of accountants and auditors that establish financial reporting standards. Regulatory authorities are government agencies that have the legal authority to enforce compliance with financial reporting standards. Regulatory authorities, such as the Securities and Exchange Commission (SEC) in the U.S. and the

Financial Services Authority (FSA) in the United Kingdom, are established by national governments. Most national authorities belong to the International Organization of Securities Commissions (IOSCO).

Question #27 of 76

Question ID: 414057

Management disclosure of the likely impact of implementing recently issued accounting standards is *least* likely to:

- ✗ **A)** **conclude that the standard will not affect the financial statements materially.**
- ✗ **B)** conclude that the standard does not apply.
- ✓ **C)** state that the impact of the standard is impossible to determine.

Explanation

A disclosure that is required for public companies is the likely impact of implementing recently issued accounting standards. Management can discuss the impact of adopting the standard, conclude that the standard does not apply or will not affect the financial statements materially, or state that they are still evaluating the effects of the new standards. Analysts should be aware of the uncertainty that this last statement implies.

Question #28 of 76

Question ID: 413999

The Management Discussion and Analysis (MD&A) portion of the financial disclosure is *least likely* required to discuss:

- ✗ **A)** **capital resources and liquidity.**
- ✓ **B)** unusual or infrequent items.
- ✗ **C)** results of operations.

Explanation

The MD&A portion of the financial disclosure is required to discuss results of operations, capital resources and liquidity and a general business overview based on known trends. A discussion of unusual or infrequent items may be included in the MD&A, but is not required.

Question #29 of 76

Question ID: 413990

Which of the following statements about financial statement analysis and reporting is *least* accurate?

- ✗ **A)** **Providing information about changes in a company's financial position is a role of financial reporting.**
- ✗ **B)** Deciding whether to recommend a company's securities to investors is a role of financial statement analysis.
- ✓ **C)** Financial statement analysis focuses on the way companies show their financial performance to investors by preparing and presenting financial statements.

Explanation

Financial reporting refers to the way companies show their financial performance to investors, creditors, and other interested parties by preparing and presenting financial statements, including information about changes in a company's financial position. The role of financial statement analysis is to use the information in a company's financial statements, along with other relevant information, to make economic decisions, such as whether to invest in the company's securities or recommend them to other investors. Analysts use financial statement data to evaluate a company's past performance and current financial position in order to form opinions about the company's ability to earn profits and generate cash flow in the future.

Question #30 of 76

Question ID: 414045

According to the IASB conceptual framework, characteristics that enhance relevance and faithful representation include:

✗ **A)** **comparability and thoroughness.**

✓ **B)** timeliness and verifiability.

✗ **C)** assurance and understandability.

Explanation

The four characteristics that enhance relevance and faithful representation are comparability, verifiability, timeliness, and understandability.

Question #31 of 76

Question ID: 414009

In the financial statement analysis framework, using the data to address the objectives of the analysis and deciding what conclusions or recommendations the information supports is *best* described as:

✓ **A)** **analyzing and interpreting the data.**

✗ **B)** reporting the conclusions.

✗ **C)** processing the data.

Explanation

The financial statement analysis framework consists of six steps:

1. *State the objective and context.* Determine what questions the analysis is meant to answer, the form in which it needs to be presented, and what resources and how much time are available to perform the analysis.
2. *Gather data.* Acquire the company's financial statements and other relevant data on its industry and the economy. Ask questions of the company's management, suppliers, and customers, and visit company sites.
3. *Process the data.* Make any appropriate adjustments to the financial statements. Calculate ratios. Prepare exhibits such as graphs and common-size balance sheets.
4. *Analyze and interpret the data.* Use the data to answer the questions stated in the first step. Decide what conclusions or recommendations the information supports.
5. *Report the conclusions or recommendations.* Prepare a report and communicate it to its intended audience. Be sure the report and its dissemination comply with the Code and Standards that relate to investment analysis and recommendations.
6. *Update the analysis.* Repeat these steps periodically and change the conclusions or recommendations when necessary.

Question #32 of 76

Question ID: 414033

Jack Rivers is an investment analyst for the equity fund of a family office. The head of the family, Charlotte Blackmon, is concerned that management may be manipulating the earnings of some of the companies that the fund invests in. Rivers explains to Blackmon, "Even though we don't have access to the detailed transactions that underlie the financial statements, we can be sure that management is not manipulating earnings because I read the footnotes to the financial statements of every company we invest in. The footnotes would disclose any deviation from appropriate accounting parameters." Rivers is:

- ✗ **A)** **correct.**
- ✓ **B)** incorrect because even within appropriate accounting parameters, management can manipulate earnings through the assumptions that rely on their discretion.
- ✗ **C)** incorrect because deviation from appropriate accounting parameters is addressed in the auditor's report, so a qualified opinion in the auditor's report ensures that management is not manipulating earnings.

Explanation

Because adjustments and assumptions within the financial statements are to some extent at the discretion of management, the possibility exists that management can try to manipulate or misrepresent the company's financial performance. A clean auditor's report does not ensure that management is unable to manipulate earnings, and a qualified opinion expresses reservations about the appropriateness of accounting policies. An analyst doesn't have access to the detailed information that flows through a company's accounting system, but only sees its end product, the financial statements.

Question #33 of 76

Question ID: 414036

Which of the following statements about financial statements and reporting standards is *least* accurate?

- ✓ **A)** **Reporting standards focus mostly on format and presentation and allow management wide latitude in assumptions.**
- ✗ **B)** The objective of financial statements is to provide economic decision makers with useful information.
- ✗ **C)** Financial statements could potentially take any form if reporting standards didn't exist.

Explanation

Given the variety and complexity of possible transactions, and the estimates and assumptions a firm must make when presenting its performance, financial statements could potentially take any form if reporting standards didn't exist. Reporting standards ensure that the information is "useful to a wide range of users," including security analysts, by making financial statements comparable to one another and narrowing the range within which management's estimates can be seen as reasonable. Reporting standards limit the range of assumptions management can make.

Question #34 of 76

Question ID: 414022

Which of the following is the *least likely* to be considered an accrual for accounting purposes?

- ✗ **A)** **Unearned revenue.**
- ✓ **B)** Accumulated depreciation.
- ✗ **C)** Wages payable.

Explanation

Accruals fall into four categories:

1. Unearned revenue.
2. Accrued revenue.
3. Prepaid expenses.
4. Accrued expenses. Wages payable are a common example of an accrued expense.

Accumulated depreciation is considered a contra-asset account to property, plant and equipment, not an accrual.

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Question ID: 414017

Washburn Motors signs a contract to sell a $100,000 luxury sedan to be delivered next month, and receives a $20,000 cash down payment from the buyer. How will the transaction *most likely* affect Washburn's assets and liabilities?

		Assets	Liabilities
✗	**A)**	**Increase**	**Unchanged**
✓	**B)**	Increase	Increase
✗	**C)**	Unchanged	Unchanged

Explanation

The down payment will increase cash (an asset) and unearned revenue (a liability). Revenues (and thus retained earnings and owner's equity) will not increase because the car has not been delivered.

Question #36 of 76

Question ID: 485771

Making a profitable sale on credit is *most likely* to have which of the following effects?

✗ **A)** **Increase assets and decrease liabilities.**

✓ **B)** Increase assets and increase equity.

✗ **C)** Decrease assets and increase equity.

Explanation

Making a profitable sale on credit will increase accounts receivable and decrease inventory. Given that the sale is profitable, the increase in accounts receivable will be greater than the decrease in inventory, resulting in a net increase in assets. Profit (due to sales being greater than cost of goods sold) will increase net income and retained earnings (equity).

Question #37 of 76

Question ID: 414002

Which of the following is an independent auditor *least likely* to do with respect to a company's financial statements?

✓ **A)** **Prepare and accept responsibility for them.**

✗ **B)** Provide an opinion concerning their fairness and reliability.

✗ **C)** Confirm assets and liabilities contained in them.

Explanation

Auditors make an independent review of financial statements, which are prepared by company management and are management's responsibility. It is the responsibility of auditors to confirm the assets, liabilities, and other items included in the statements and then issue an opinion concerning their fairness and reliability.

Question #38 of 76

Question ID: 414027

A listing of all the firm's journal entries by date is called the:

✗ **A)** **adjusted trial balance.**

✗ **B)** general ledger.

✓ **C)** general journal.

Explanation

A listing of all the journal entries in order by date is called the "general journal." The *general ledger* sorts the entries in the general journal by account. At the end of the accounting period, an *initial trial balance* is prepared that shows the balances in each account. If any adjusting entries are needed, they will be recorded and reflected in an *adjusted trial balance*. The account balances from the adjusted trial balance are presented in the *financial statements*.

Question #39 of 76

Question ID: 485769

In addition to the audited financial statements included in a firm's annual report, which of the following sources of information is *most likely* to contain audited data?

✓ **A)** **Footnotes to the annual financial statements.**

✗ **B)** Management's commentary.

✗ **C)** Interim financial statements filed with the SEC.

Explanation

The footnotes are an integral part of the audited financial statements in a firm's annual report and are included in the audit opinion.

Question #40 of 76

Question ID: 414049

Which of the following is a company *least* likely required to present according to International Accounting Standard (IAS) No. 1?

✗ **A)** **Statement of changes in owners' equity.**

✗ **B)** A summary of accounting policies.

✓ **C)** Disclosures of material events.

Explanation

International Accounting Standard (IAS) No. 1 defines which financial statements are required and how they must be presented. The required financial statements are:

> • Balance sheet.
>
> • Statement of comprehensive income.
>
> • Cash flow statement.
>
> • Statement of changes in equity.
>
> • Explanatory notes, including a summary of accounting policies.

Disclosures of material events that affect the company are required by the Securities and Exchange Commission (Form 8-K) for firms that are publicly traded in the United States.

Question #41 of 76

Question ID: 414058

An analyst is *least* likely to use disclosures of accounting policies and estimates to evaluate:

✗ **A)** **whether the disclosures have changed since the prior period.**

✓ **B)** what policies are likely to be modified in future periods.

✗ **C)** what policies are discussed.

Explanation

Companies that prepare financial statements under IFRS or U.S. GAAP must disclose their accounting policies and estimates in the footnotes and Management's Discussion and Analysis. An analyst should use these disclosures to evaluate what policies are discussed, whether they cover all the relevant data in the financial statements, which policies required management to make estimates, and whether the disclosures have changed since the prior period.

Question #42 of 76

Question ID: 485772

According to the IASB Conceptual Framework for Financial Reporting, one of the qualitative characteristics of financial statements is:

✗ **A)** **going concern.**

✓ **B)** faithful representation.

✗ **C)** timeliness.

Explanation

In the IASB conceptual framework, the two qualitative characteristics of financial statements are relevance and faithful representation. Timeliness is a characteristic that enhances relevance and faithful representation. Going concern is an underlying assumption of financial statements.

Question #43 of 76

Question ID: 414026

The *best* description of the general ledger is that it:

✗ **A)** **groups accounts into the categories that are presented in the financial statements.**

✗ **B)** is where journal entries are first recorded.

✓ **C)** sorts the entries in the general journal by account.

Explanation

Information flows through an accounting system in four steps:
1. *Journal entries* record every transaction, showing which accounts are changed by what amounts. A listing of all the journal entries in order by date is called the "general journal."
2. The *general ledger* sorts the entries in the general journal by account.
3. At the end of the accounting period, an *initial trial balance* is prepared that shows the balances in each account. If any adjusting entries are needed, they will be recorded and reflected in an *adjusted trial balance*.
4. The account balances from the adjusted trial balance are presented in the *financial statements*.

Question #44 of 76

Question ID: 414012

A company's chart of accounts is:

✗ **A)** **the set of journal entries that makes up the components of owners' equity.**

✓ **B)** a detailed list of the accounts that make up the five financial statement elements.

✗ **C)** used for entries that offset other accounts.

Explanation

A company's chart of accounts is a detailed list of the accounts that make up the five financial statement elements and the line items presented in the financial statements. Contra accounts are used for entries that offset other accounts. The categories that make up owners' equity are capital, additional paid-in capital, retained earnings and other comprehensive income.

Question #45 of 76

Question ID: 414041

The term "convergence" is *most* accurately used to describe:

✗ **A)** **the reduction of the premium on a bond as it nears maturity.**

✓ **B)** the process of developing one universally accepted set of accounting standards.

✗ **C)** when expected return and required return are equal.

Explanation

Moving towards agreement on a single set of accounting standards is referred to as "convergence."

Question #46 of 76

Question ID: 414047

Which of the following is *least likely* a qualitative characteristic accounting information must possess in order to provide useful information to an analyst, according to the IASB Conceptual Framework?

✗ **A)** **Faithful representation.**

✗ **B)** Relevance.

✓ **C)** Conservatism.

Explanation

Qualitative characteristics that accounting information must possess according to the IASB Conceptual Framework are relevance and faithful representation, which are enhanced by the characteristics of timeliness, verifiability, understandability, and comparability. Conservatism may be a desirable characteristic, but is not one of the qualitative characteristics specified in the IASB Conceptual Framework.

Question #47 of 76

Question ID: 414028

Which of the following is the *best* description of the flow of information in an accounting system?

✓ **A)** **Journal entries, general ledger, trial balance, financial statements.**

✗ **B)** Trial balance, general ledger, general journal, financial statements.

✗ **C)** General ledger, trial balance, general journal, financial statements.

Explanation

Information flows through an accounting system in four steps:

1. *Journal entries* record every transaction, showing which accounts are changed by what amounts. A listing of all the journal entries in order by date is called the "general journal."
2. The *general ledger* sorts the entries in the general journal by account.
3. At the end of the accounting period, an *initial trial balance* is prepared that shows the balances in each account. If any adjusting entries are needed, they will be recorded and reflected in an adjusted trial balance.
4. The account balances from the adjusted trial balance are presented in the *financial statements*.

Question #48 of 76

Question ID: 414016

A furniture store acquires a set of chairs for $750 cash and sells them for $1000 cash. These transactions are *most likely* to affect which accounts?

	Purchase	Sale
✓ **A)**	**Assets only**	**Assets, revenue, expenses, owners' equity**
✗ **B)**	Assets and expenses	Assets, revenue, expenses, owners' equity
✗ **C)**	Assets only	Assets and revenues only

Explanation

The purchase will be a decrease in cash and an increase in inventory, both asset accounts. The expense is not recorded until the chairs are sold. The sale will be a decrease in inventory and an increase in cash (assets), an increase in sales (revenues), an increase in cost of goods sold (expenses), and an increase in retained earnings (owners' equity) for the $250 profit.

Question #49 of 76

Question ID: 414055

Disagreements that inhibit development of a coherent financial reporting framework are *least* likely to involve which of the following?

✗ **A)** **Standard setting.**
✓ **B)** Transparency.
✗ **C)** Valuation.

Explanation

There is widespread agreement that transparency is desirable in financial reporting. Disagreements that inhibit development of a single framework often arise around issues of measurement, valuation, and standard setting.

Question #50 of 76

Question ID: 413998

Which of the following statements regarding footnotes to the financial statements is *least* accurate?

✗ **A)** **Footnotes may contain information regarding contingent losses.**
✗ **B)** Footnotes provide information about assumptions and estimates used by management.
✓ **C)** Some supplementary schedules are audited whereas footnotes are not audited.

Explanation

Some supplementary schedules are not audited whereas footnotes are audited. The financial statements and footnotes in the annual report and the SEC 10-k filings are all audited.

Question #51 of 76

Question ID: 414054

Which of the following is *least* likely to be considered a characteristic of a coherent financial reporting framework?

✗ **A)** **Transparency.**
✓ **B)** Stability.
✗ **C)** Comprehensiveness.

Explanation

Financial reporting should be transparent and comprehensive. Stability of accounting information is not a characteristic of a coherent reporting framework.

Question #52 of 76

Question ID: 414007

The step in the financial statement analysis framework that includes making any appropriate adjustments to the financial statements and calculating ratios is *best* described as:

✗ **A)** **gathering the data.**

✓ **B)** processing the data.

✗ **C)** analyzing and interpreting the data.

Explanation

The financial statement analysis framework consists of six steps:
1. *State the objective and context.* Determine what questions the analysis is meant to answer, the form in which it needs to be presented, and what resources and how much time are available to perform the analysis.
2. *Gather data.* Acquire the company's financial statements and other relevant data on its industry and the economy. Ask questions of the company's management, suppliers, and customers, and visit company sites.
3. *Process the data.* Make any appropriate adjustments to the financial statements. Calculate ratios. Prepare exhibits such as graphs and common-size balance sheets.
4. *Analyze and interpret the data.* Use the data to answer the questions stated in the first step. Decide what conclusions or recommendations the information supports.
5. *Report the conclusions or recommendations.* Prepare a report and communicate it to its intended audience. Be sure the report and its dissemination comply with the Code and Standards that relate to investment analysis and recommendations.
6. *Update the analysis.* Repeat these steps periodically and change the conclusions or recommendations when necessary.

Question #53 of 76

Question ID: 413994

A company's operating revenues for a reporting period are *most likely* to be shown on its:

✗ **A)** **cash flow statement.**

✗ **B)** balance sheet.

✓ **C)** income statement.

Explanation

Revenues for a reporting period are presented on a company's income statement. They can be, but are not required to be, classified as operating and nonoperating revenues. Cash from operating activities is presented on the company's statement of cash flows, but this is not necessarily equal to operating revenues because revenue might be recognized in a different period than cash is collected. The balance sheet displays a company's financial position at a fixed point in time.

Question #54 of 76

Question ID: 414044

Two underlying assumptions of financial statements, according to the IASB conceptual framework, are:

✓ **A)** **going concern and accrual accounting.**

✗ **B)** accrual accounting and historical cost.

✗ **C)** historical cost and going concern.

Explanation

The two underlying assumptions of financial statements according to the conceptual framework are accrual accounting and the going concern assumption. Historical cost is one of several measurement bases that may be used for financial reporting.

Question #55 of 76

Question ID: 413991

Which of the following *best* describes financial reporting and financial statement analysis?

✓ **A) Financial reporting refers to how companies show their financial performance and financial analysis refers to using the information to make economic decisions.**

✗ **B)** The objective of financial analysis is to provide information about the financial position of an entity that is useful to a wide range of users.

✗ **C)** Financial reports assess a company's past performance in order to draw conclusions about the company's ability to generate cash and profits in the future.

Explanation

Financial reporting refers to the way companies show their financial performance to investors, creditors, and other interested parties by preparing and presenting financial statements. The objective of financial statements, not analysis, is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. The role of financial statement analysis, not reporting, is to use the information in a company's financial statements, along with other relevant information, to assess a company's past performance in order to draw conclusions about the company's ability to generate cash and profits in the future.

Question #56 of 76

Question ID: 414018

The purchase of equipment for $25,000 cash is *most likely* to be recorded as:

✗ **A) an increase in an asset account and an increase in a liability account.**

✓ **B)** an increase in one asset account and a decrease in another asset account.

✗ **C)** an increase in two asset accounts.

Explanation

The purchase of equipment for cash is an increase in property, plant and equipment (an asset) and a decrease in cash (another asset).

Question #57 of 76

Question ID: 434268

An analyst can find a company's accounting policies that require significant judgement or estimates in:

✓ **A) both the footnotes to the financial statements and Management's Discussion and Analysis.**

✗ **B)** only the footnotes.

✗ **C)** both the footnotes and in the auditor's opinion.

Explanation

Companies that prepare financial statements under IFRS or U.S. GAAP must disclose their accounting policies and estimates in the footnotes and address those policies and estimates where significant judgment was required in Management's Discussion and Analysis. The auditor's opinion discusses whether policies have been applied appropriately, but does not include the estimates and policies themselves.

Question #58 of 76

Question ID: 414019

Which of the following *least* accurately describes a correct use of double-entry accounting?

✓ **A) A decrease in a liability account may be balanced by a decrease in another liability account.**

✗ **B)** A transaction may be recorded in more than two accounts.

✗ **C)** An increase in an asset account may be balanced by an increase in an owner's equity account.

Explanation

Keeping the accounting equation in balance requires double-entry accounting, in which a transaction has to be recorded in at least two accounts. An increase in an asset account, for example, must be balanced by a decrease in another asset account or by an increase in a liability or owners' equity account. A decrease in a liability account may be balanced by an increase in another liability account, not a decrease. If two liabilities decrease without a balancing entry, the balance sheet will be out of balance.

Question #59 of 76

Question ID: 414051

Under which framework for financial reporting systems are the financial statement elements related to performance defined as revenues, expenses, gains, losses, and comprehensive income?

✓ **A) FASB framework.**

✗ **B)** Both IASB and FASB frameworks.

✗ **C)** IASB framework.

Explanation

The FASB framework lists revenues, expenses, gains, losses, and comprehensive income as elements related to performance. In the IASB framework, elements related to performance are income and expenses.

Question #60 of 76

Question ID: 414008

The step in the financial statement analysis framework of "processing the data" is *least likely* to include which activity?

- ✗ **A) Making appropriate adjustments to the financial statements.**
- ✓ **B)** Acquiring the company's financial statements.
- ✗ **C)** Preparing exhibits such as graphs.

Explanation

The financial statement analysis framework consists of six steps. Step 2: "Gather data" includes acquiring the company's financial statements and other relevant data on its industry and the economy. Step 3. "Process the data" includes activities such as making any appropriate adjustments to the financial statements and preparing exhibits such as graphs and common-size balance sheets.

Question #61 of 76

Question ID: 414035

Which description of the objective of financial statements is *most* accurate? The objective of financial statements is:

- ✗ **A) to provide a wide range of users with information about a firm's financial prospects.**
- ✓ **B)** to provide economic decision makers with useful information about a firm's financial performance and changes in financial position.
- ✗ **C)** to provide securities analysts with objective data about a firm's financial prospects.

Explanation

The objective of financial statements is to provide economic decision makers with useful information about a firm's financial performance and changes in financial position. Assessing its prospects is the responsibility of analysts. Financial statements fall under the purview of the FASB in the US, not the IASB. The SEC does not set the objectives of financial statements, it is a regulatory authority.

Question #62 of 76

Question ID: 414032

Sergey Martinenko is an investment analyst with Profis, Martinenko and Verona. He is explaining to his new assistant, John Stevenson, why it is crucial for an investment analyst to read the footnotes to a firm's financial statement and the Management Discussion and Analysis (MD&A) before making an investment decision. Which rationale is Martinenko *least likely* to provide to Stevenson regarding the importance of analyzing the footnotes and MD&A?

- ✓ **A) The footnotes disclose whether or not the company is adhering to GAAP.**
- ✗ **B)** Evaluating the footnotes helps the analyst assess whether management is manipulating earnings.
- ✗ **C)** Accruals, adjustments and assumptions are often explained in the footnotes and MD&A.

Explanation

Various accruals, adjustments, and management assumptions that went into the financial statements are often explained in the footnotes to the statements and in Management's Discussion and Analysis. Because adjustments and assumptions within the financial statements are to some extent at the discretion of management, the possibility exists that management can try to manipulate or misrepresent the company's financial performance. With this information, the analyst can better judge how well the financial statements reflect the company's true performance, and in what ways he needs to adjust the data for his own analysis. Whether or not the company is adhering to GAAP is addressed in the auditor's opinion, not the footnotes.

Question #63 of 76

Question ID: 414046

According to the IFRS framework, timeliness is a characteristic that enhances:

- ✗ **A)** **faithful representation.**
- ✗ **B)** relevance.
- ✓ **C)** both relevance and faithful representation.

Explanation

In the IFRS framework, timeliness, comparability, verifiability, and understandability are characteristics that enhance the two fundamental qualitative characteristics, relevance and faithful representation.

Question #64 of 76

Question ID: 414040

Which of the following is *least* likely to be considered a stated goal of the International Accounting Standards Board (IASB)?

- ✗ **A)** **Develop global accounting standards requiring transparency, comparability, and high quality in financial statements.**
- ✓ **B)** Remain neutral in the debate on the use of global accounting standards to avoid appearance of a conflict of interest.
- ✗ **C)** Account for the needs of emerging markets and small firms when implementing global accounting standards.

Explanation

The IASB has four stated goals:
1. Develop global accounting standards requiring transparency, comparability, and high quality in financial statements.
2. Promote the use of global accounting standards.
3. Account for the needs of emerging markets and small firms when implementing global accounting standards.
4. Achieve convergence between various national accounting standards and global accounting standards.

Question #65 of 76

Question ID: 414030

Regarding the use of financial statements in security analysis and selection, it would be *most* accurate to say that:

- ✗ **A)** **analysts can verify the accuracy of financial statements by using a firm's detailed accounting system information.**
- ✗ **B)** further analysis of a firm's financial statements is typically not necessary if the firm has conformed to applicable accounting principles.

✓ **C)** analysts can use footnotes and Management's Discussion and Analysis to better understand assumptions used in the financial statements.

Explanation

Analysts must have a good understanding of a firm's accounting process and must read the footnotes to the financial statement as well as Management's Discussion and Analysis to better understand assumptions used in the financial statements. Even if the firm conforms to appropriate accounting principles, there is still room for management discretion. Because analysts do not have access to a firm's detailed accounting information, they must rely on what they can glean from the footnotes and Management's Discussion and Analysis.

Question #66 of 76

Question ID: 414042

Which of the following is *most* likely to be considered a barrier to developing one universally recognized set of reporting standards?

✗ **A) Reluctance of firms to adhere to a single set of reporting standards.**

✓ **B)** Different standard-setting bodies of different countries disagree on the best treatment of a particular issue.

✗ **C)** GATT already requires sufficient agreement.

Explanation

A principal obstacle to agreement on a single set of reporting standards is that various standard-setting bodies and regulatory authorities disagree on what the standards should be. Firms generally support the idea because it would reduce the cost of reporting. GATT is the General Agreement on Tariffs and Trade and does not relate to financial reporting.

Question #67 of 76

Question ID: 414006

Which of the following is the *best* description of the financial statement analysis framework?

✓ **A) State the objective and context, gather data, process the data, analyze and interpret the data, report the conclusions or recommendations, update the analysis.**

✗ **B)** Gather data, analyze and interpret the data, determine the context, report the conclusions, update the analysis.

✗ **C)** Gather data, analyze and interpret the data, process the conclusions, assess the context, report the recommendations, update the analysis.

Explanation

The financial statement analysis framework consists of six steps:

1. *State the objective and context.*
2. *Gather data.*
3. *Process the data.*
4. *Analyze and interpret the data.*
5. *Report the conclusions or recommendations.*

6. *Update the analysis.*

Question #68 of 76

Question ID: 414048

Required financial statements, according to International Accounting Standard (IAS) No. 1, include a(n):

✓ **A) balance sheet and explanatory notes.**

✗ **B)** cash flow statement and auditor's report.

✗ **C)** income statement and working capital summary.

Explanation

Financial statements that are required by IAS No. 1 include a balance sheet, a statement of comprehensive income, a cash flow statement, a statement of changes in owners' equity, and explanatory notes that include a summary of the company's accounting policies. IAS No. 1 does not require an auditor's report or a working capital summary.

Question #69 of 76

Question ID: 414015

The following amounts were drawn from the records of JME Company: total assets = $1,200; total liabilities = $750; contributed capital = $600. Based on this information alone, retained earnings must be equal to:

✓ **A) −$150.**

✗ **B)** $150.

✗ **C)** $450.

Explanation

(1,200 − 750 − 600) = −150

Question #70 of 76

Question ID: 414000

The standard auditor's report is *most likely* required to:

✗ **A) provide reasonable assurance that management is reliable.**

✗ **B)** provide an "unqualified" opinion if material uncertainties exist.

✓ **C)** provide reasonable assurance that the financial statements contain no material errors.

Explanation

The standard auditor's report contains three parts:

1. The financial statements are prepared by management and are their responsibility and the auditor has performed an independent review.
2. The audit was conducted using generally accepted auditing standards, which provides reasonable assurance that there are no material errors in the financial statements.
3. The auditor is satisfied the statements were prepared in accordance with accepted accounting principles, and the

principles chosen and estimates are reasonable.

Under U.S. GAAP, the auditor is required to state an opinion on the company's internal controls. The auditor may add this opinion as a fourth element of the auditor's report or provide it separately.

Question #71 of 76

Question ID: 414034

Which of the following statements about financial reporting standards is *least* accurate? Reporting standards:

✗ **A)** **narrow the range within which management estimates can be seen as reasonable.**

✓ **B)** are disclosed on Form 8K by publicly traded firms in the United States.

✗ **C)** ensure that the information is "useful to a wide range of users."

Explanation

Reporting standards ensure that the information is "useful to a wide range of users," including security analysts, by making financial statements comparable to one another and narrowing the range within which management's estimates can be seen as reasonable. Securities & Exchange Commission Form 8K addresses acquisitions, divestitures, etc. and not reporting standards.

Question #72 of 76

Question ID: 413997

Which of the following statements concerning the notes to the audited financial statements of a company is *least* accurate? Financial statement notes:

✗ **A)** **contain information about contingent losses that may occur.**

✓ **B)** include management's assessment of the company's operating performance and financial results.

✗ **C)** are audited.

Explanation

Management's perspective on the company's results is provided in the Management's Discussion and Analysis supplement to the financial statements. Financial statement notes (footnotes) provide information about matters such as the company's accounting methods and assumptions, contingencies, and acquisitions and disposals. Footnotes to the financial statements are audited.

Question #73 of 76

Question ID: 414037

Desirable attributes of accounting standard-setting bodies *least likely* include:

✗ **A)** **making decisions that are in the public interest.**

✓ **B)** operating independently of interested stakeholders.

✗ **C)** having clear and consistent standard-setting processes.

Explanation

Although standard-setting bodies should not be compromised by special interests, seeking input from stakeholders is considered a desirable attribute.

Question #74 of 76

Question ID: 414005

Which of the following is *least likely* to be available on EDGAR (Electronic Data Gathering, Analysis, and Retrieval System)?

✗ **A)** **SEC filings.**

✓ **B)** Corporate press releases.

✗ **C)** Form 10Q.

Explanation

Securities and Exchange Commission (SEC) filings are available from EDGAR (Electronic Data Gathering, Analysis, and Retrieval System, www.sec.gov). Companies' annual and quarterly financial statements are also filed with the SEC (Form 10-K and Form 10-Q, respectively).

Question #75 of 76

Question ID: 414043

The process of developing one universally accepted set of accounting standards is *best* described as:

✗ **A)** **unification.**

✓ **B)** convergence.

✗ **C)** IASB.

Explanation

Developing one universally accepted set of accounting standards is referred to as "convergence." The IASB is an accounting standard setting body involved in the process.

Question #76 of 76

Question ID: 414052

Which of the following statements about the elements of financial statements under the FASB and IASB frameworks is *least* accurate?

✗ **A)** The IASB framework lists income and expenses as the elements related to performance.

✓ **B)** The IASB framework does not allow the values of assets to be adjusted upward.

✗ **C)** **The word "probable" is used by the FASB to define assets and liabilities.**

Explanation

Differences in financial statement elements include: (1) The IASB framework lists income and expenses as the elements related to performance, while the FASB framework uses revenues, expenses, gains, losses, and comprehensive income. (2)

FASB defines an asset as a future economic benefit, where IASB defines it as a resource from which a future economic benefit is expected. (3) The word "probable" is used by the FASB to define assets and liabilities. (4) The FASB framework does not allow the values of most assets to be adjusted upward.