LO.a: Describe the roles of financial reporting and financial statement analysis.

1. Providing information about the performance of a company, its financial position, and changes in financial position are *best* described as a role of:
   A. auditor’s report.
   B. financial reporting.
   C. financial statement analysis.

2. Which of the following is *most likely* to be the role of financial reporting?
   A. Provide information about a company’s performance, financial position, and changes in financial position that is useful to a wide range of users.
   B. Use financial statements to evaluate the past, present, and future performance of the company for the purpose of making investment decisions.
   C. Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement.

LO.b: Describe the roles of the key financial statements (statement of financial position, statement of comprehensive income, statement of changes in equity, and statement of cash flows) in evaluating a company’s performance and financial position.

3. An analyst wants to study the changes that have occurred in a company’s retained earnings over the year. The financial statement that would be helpful in this situation is the statement of:
   A. changes in equity.
   B. comprehensive income.
   C. financial position.

4. A financial analyst wishes to evaluate a company’s current financial position. Which of the following financial statements is he *most likely* to use?
   A. Balance sheet.
   B. Income statement.
   C. Statement of cash flows.

5. James Calloway, an equity analyst, wants to find out the basic and diluted earnings per share of a company. In which of the following financial statements is he *most likely* to find this information?
   A. Income statement.
   B. Statement of cash flows.
   C. Statement of changes in equity.

6. Amber Reza is concerned about whether her business is generating enough cash. She has to pay off short term debts, utility bills, and other miscellaneous expenses. The ability of her firm to meet short term obligations is known as:
   A. liquidity.
   B. profitability.
   C. solvency.

7. Samantha Stoser is a financial analyst. She wishes to analyze the changes in the owners' investment in the business over time. Which of the following financial statements is Stoser *most likely* to use for her analysis?
   A. Statement of changes in equity.
   B. Statement of comprehensive income.
   C. Statement of financial position.

8. The owner's equity is:
   A. excess of liabilities over assets.
   B. excess of assets over liabilities.
   C. sum of assets and liabilities.

9. Sanjeev Dugar is an accountant at Yellow Cabs Ltd. The company disposed of some fixed assets during the year. Dugar wishes to account for this in the cash flow statement. Which of the following categories would he *most likely* record this transaction in?
   A. Financing activities.
   B. Investing activities.
   C. Operating activities.

LO.c: Describe the importance of financial statement notes and supplementary information—including disclosures of accounting policies, methods, and estimates—and management's commentary.

10. Which of the following is *most likely* to be included in the financial notes and supplementary schedules?
    A. Critical performance measures.
    B. Future economic outlook.
    C. Revenue recognition policy.

11. Management discussion and analysis is *least likely* to include information on:
    A. future outlook.
    B. planned expenditures.
    C. related-party transactions.

12. The information on a company's risks and resources is *most likely* found in which of the following sources?
    A. Auditor's report.
    B. Financial notes and supplementary schedules.
    C. Management's discussion and analysis.

13. Which of the following will *most likely* have information about a company's planned capital expenditures?
    A. Management discussion and analysis.
    B. Notes to the financial statements.
    C. Proxy statement.

14. Which of the following is *most likely* to appear in a company's management discussion and analysis (MD&A)?
    A. Compensation arrangements for management and directors.
    B. Potential conflicts of interest between management, directors, and shareholders.
    C. Significant events and contingencies that may affect future operations.

15. Which of the following is *least likely* to be included in the financial notes and supplementary schedules?
    A. Depreciation method for new assets.
    B. Future economic outlook.
    C. Revenue recognition policy.

16. Which of the following statements is *most* accurate about notes to the financial statements? Notes:
    A. Disclose the basis of preparation for financial statements.
    B. Provides a written opinion on the financial statements.
    C. Provides information on the nature of the business and future outlook.

LO.d: Describe the objective of audits of financial statements, the types of audit reports, and the importance of effective internal controls.

17. An analyst, while reviewing the audit report, comes across an additional paragraph that explains an exception to an accounting standard. This additional paragraph can be *best* described as a(n):
    A. adverse opinion.
    B. disclaimer of opinion.
    C. qualified opinion.

18. Artie Sorensen, an investment manager is explaining the responsibilities of an auditor for a publicly traded firm in the United States. Which of his statements is *most accurate*? The auditor:
    A. assures the reader that the financial statements are free from error, fraud, or illegal acts.
    B. must express an opinion about the effectiveness of the company's internal control systems.
    C. must state that he prepared the financial statements according to generally accepted accounting principles.

19. Jim Jonathan is an auditor employed by a large accounting firm. While auditing the books of Simba Fans Ltd, Jonathan gave a qualified opinion. Which of the following is *most likely* to be true?
    A. Jonathan believes that the financial statements give a true and fair view.
    B. Jonathan believes that there is some scope limitation or exception to accounting standards.
    C. Jonathan believes that the financial statements materially depart from the accounting standards and are not fairly represented.

LO.e: Identify and describe information sources that analysts use in financial statement analysis besides annual financial statements and supplementary information.

20. Which of the following reports is *most likely* to be filed with the SEC?
    A. Audited quarterly financial statements.
    B. Proxy statement.
    C. Annual report.

21. Interim reports are:
    A. Audited versions of the four basic financial statements.
    B. Provided either quarterly or semi-annually.
    C. All financial statements and comprehensive notes.

LO.f: Describe the steps in the financial statement analysis framework.

22. Which of the following is *least likely* to be an output of the "process data" phase of the financial statement analysis framework?
    A. Analytical results.
    B. Common-size statements.
    C. Forecasts.

23. Which of the following activities is *least likely* a part of the "processing phase" of a financial analysis?
    A. Analyzing the prospects of the industry.
    B. Making adjustments for different accounting policies.
    C. Preparing common-sized financial statement data.

24. Graphs and forecasts are *most likely* an output of which step in the financial analysis framework?
    A. Collect data.
    B. Process data.
    C. Analyze/interpret data.

25. Which of the following activities is a part of the "collect data" phase of the financial analysis framework?
    A. Preparing common-sized financial statement data.
    B. Analyzing the prospects of the industry.
    C. Making adjustments for different accounting policies.

26. When analysts collect data, they *least likely* do which of the following?
    A. Gain an understanding of the macroeconomic environment.
    B. Determine the prospects of the company within the industry as well as the environment.
    C. Conduct an in-depth analysis of whether the data collected in the form of financial statements are in accordance with the international accounting standards.

27. Ratios is *most likely* an output of which step of financial statement analysis?
    A. Collect data.
    B. Process data.
    C. Interpret data.

28. Which of the following is *least likely* a step in the financial statement analysis framework?
    A. Articulate the purpose.
    B. Verify management commentary.
    C. Follow up.

Solutions

1. B is correct. The role of financial reporting is to provide information about the performance of a company, its financial position, and changes in financial position that is useful to a wide range of users in making economic decisions.

2. A is correct. The role of financial reporting is to provide information about a company's performance, financial position, and changes in financial position that is useful to a wide range of users.

3. A is correct. The statement of changes in equity reports the changes in the components of shareholders' equity over the year, which would include the retained earnings account.

4. A is correct. The balance sheet (also called the statement of financial position or statement of financial condition) presents a company's current financial position

5. A is correct. Basic and diluted earnings per share are presented on the income statement.

6. A is correct. The ability to meet short term obligations is known as liquidity.

7. A is correct. The statement of changes in equity provides information regarding the changes in the owners' investment in the business over time. The statement of financial position only gives the company's financial position on a particular date.

8. B is correct. Owner's equity is excess of assets over liabilities.

9. B is correct. Cash flows from investing activities are associated with the acquisition and disposal of long term assets, such as property and equipment.

10. C is correct. A company's significant accounting choices, such as how it recognizes its revenues, must be discussed in the notes to the financial statements

11. C is correct. Related-party transaction information is found in the notes to the financial statements.

12. C is correct. The management commentary or MD&A includes information on the company's significant resources, risks and relationships.

13. A is correct. A company's forward-looking information such as those about planned capital expenditures is typically provided in the management discussion and analysis (MD&A).

14. C is correct. Significant events, conditions, trends, and contingencies that may affect future operations are contained in the management discussion and analysis. Compensation agreements for directors and management, and their potential conflicts of interest are required in the proxy statement.

15. B is correct. Future economic outlook is provided in the Management's Discussion and Analysis (MD&A) rather than in the financial notes and supplementary schedules.

16. A is correct. Notes include disclosures on accounting methods, estimates, assumptions. They also disclose the basis of preparation for the financial statements.

17. C is correct. A qualified opinion is one in which there is some scope limitation or exception to accounting standards that is described in additional explanatory paragraphs.

18. B is correct. For a publicly traded firm in the United States, the auditor must express an opinion as to whether the company's internal control system is in accordance with the Public Company Accounting Oversight Board, under the Sarbanes–Oxley Act. This is done either as a final paragraph in the auditor's report or as a separate opinion.

19. B is correct. A qualified opinion means that the auditor believes that there is some scope limitation or exception to accounting standards.

20. B is correct. Proxy statements must be filed with the SEC. IAS No. 1 requires companies to file audited financial statement at least annually. The annual report is not a requirement of the SEC.

21. B is correct. A is incorrect because they are not audited. C is incorrect because they include condensed notes and only four basic financial statements.

22. A is correct. Analytical results is an output of the analyze the processed data phase.

23. A is correct. Analyzing the prospects of the industry would be done in the collect data phase of a financial analysis.

24. B is correct. Ratios, graphs and forecasts are an output of the process data step.

25. B is correct. Analyzing the prospects of the industry is a part of the data collection phase of financial analysis. On the other hand, preparing common-sized financial statements and making adjustments for different accounting policies would be done in the data processing phase.

26. C is correct. An in-depth analysis of whether the financial statements are in accordance with the international accounting standards is part of the auditor's scope. The analyst is required to check the audit report and the auditor's opinion before considering the data in the financial statements.

27. B is correct. Ratios are an output of the "process data" phase.

28. B is correct. Verification of the management commentary is not a step in the financial statement analysis framework.