



FINANCIAL REPORTING AND ANALYSIS

SAMPLE QUESTIONS

SECTION A

1. The balance sheet equation can be defined as which of the following?
 - a. $\text{Assets} + \text{Stockholders' Equity} = \text{Liabilities}$
 - b. $\text{Assets} + \text{Liabilities} = \text{Stockholders' Equity}$
 - c. $\text{Assets} = \text{Liabilities} - \text{Stockholders' Equity}$
 - d. $\text{Assets} - \text{Liabilities} = \text{Stockholders' Equity}$
 - e. None of the above

2. If assets are \$40,000 and stockholders' equity is \$10,000, how much are liabilities?
 - a. \$30,000
 - b. \$50,000
 - c. \$20,000
 - d. \$60,000
 - e. \$10,000

3. If assets are \$100,000 and liabilities are \$40,000, how much is stockholders' equity?
 1. \$40,000
 2. \$50,000
 3. \$60,000
 4. \$30,000
 5. \$140,000

4. Which is a permanent account?
 - a. Revenue
 - b. Advertising Expense
 - c. Accounts Receivable
 - d. Dividends
 - e. Insurance Expense

5. Which is a temporary account?
- Cash
 - Accounts Receivable
 - Insurance Expense
 - Accounts Payable
 - Notes Payable
6. In terms of debits and credits, which accounts have the same normal balances?
- Dividends, retained earnings, liabilities
 - Capital stock, liabilities, expenses
 - Revenues, capital stock, expenses
 - Expenses, assets, dividends
 - Dividends, assets, liabilities
7. Audit opinions cannot be classified as which of the following?
- All-purpose
 - Disclaimer of opinion
 - Adverse opinion
 - Qualified opinion
 - Unqualified opinion
8. From the point of view of analysis, which classification of an audit opinion indicates that the financial statements carry the highest degree of reliability?
- Unqualified opinion
 - All-purpose
 - Disclaimer of opinion
 - Qualified opinion
 - Adverse opinion
9. Which one of the following statements is false?
- The reliance that can be placed on financial statements that have been reviewed is substantially less than for those that have been audited.
 - An accountant's report described as a compilation presents only financial information as provided by management.
 - A disclaimer of opinion indicates that you should not look to the auditor's report as an indication of the reliability of the statements.
 - A review has substantially less scope than an examination in accordance with generally accepted auditing standards.
 - The typical unqualified opinion has one paragraph.

10. If an accountant performs a compilation and becomes aware of deficiencies in the statements, the accountant's report characterizes the deficiencies by all but one of the following:

- a. Omission of substantially all disclosures
- b. Omission of statement of cash flows
- c. Accounting principles not generally accepted
- d. All of the above
- e. None of the above

11. In addition to the company's principal financial statements, the Form 10-K and shareholder annual reports must include all but one of the following:

- a. Information on the market for holders of common stock and related securities, including high and low sales price, frequency and amount of dividends, and number of shares
- b. Five-year summary of selected financial data
- c. Management's discussion and analysis of financial condition and results of operations
- d. Two years of audited balance sheets, three years of audited statements of income, and two years of statements of cash flows
- e. Disclosure of the domestic and foreign components of pretax income

12. Which of these is not a suggested problem caused by lack of harmonization of international accounting standards?

- a. Positive effect on the international trade of accounting practice and services
- b. A need for employment of key personnel in multinational companies to bridge the "gap" in accounting requirements between countries
- c. Difficulties in reconciling local standards for access to other capital markets
- d. Difficulties in accessing capital markets for companies from less-developed countries
- e. Negative effect on the international trade of accounting practice and services

13. Which of these organizations has not played a role in the harmonization of international accounting standards?

- a. United Nations
- b. Internal Revenue Service
- c. International Accounting Standards Board
- d. Financial Accounting Standards Board
- e. European Economic Community

14. The Form 10-K is submitted to the:

- a. American Institute of Certified Public Accountants
- b. Securities and Exchange Commission
- c. Internal Revenue Service
- d. American Accounting Association
- e. Emerging Issues Task Force

15. Which party has the primary responsibility for the financial statements?

- a. Bookkeeper
- b. Auditor
- c. Management

- d. Cost accountant
- e. None of the above

16. Which of the following is a type of audit opinion that a firm would usually prefer?

- a. Unqualified opinion
- b. Qualified opinion
- c. Adverse opinion
- d. Clear opinion
- e. None of the above

17. A company's current ratio is 2.2 to 1 and quick (acid-test) ratio is 1.0 to 1 at the beginning of the year. At the end of the year, the company has a current ratio of 2.5 to 1 and a quick ratio of 0.8 to 1.

Which of the following could help explain the divergence in the ratios from the beginning to the end of the year?

- a. An increase in inventory levels during the current year
- b. An increase in credit sales in relationship to cash sales
- c. An increase in the use of trade payables during the current year
- d. An increase in the collection rate of accounts receivable
- e. The sale of marketable securities at a price below cost

18. If, just prior to a period of rising prices, a company changed its inventory measurement method from FIFO to LIFO, the effect in the next period would be to

- a. Increase both the current ratio and inventory turnover.
- b. Decrease both the current ratio and inventory turnover.
- c. Increase the current ratio and decrease inventory turnover.
- d. Decrease the current ratio and increase inventory turnover.
- e. Leave the current ratio and inventory turnover unchanged.

19. If a firm has a high current ratio but a low acid-test ratio, one can conclude that

- a. The firm has a large outstanding accounts receivable balance.
- b. The firm has a large investment in inventory.
- c. The firm has a large amount of current liabilities.
- d. The cash ratio is extremely high.
- e. The two ratios must be recalculated because both conditions cannot occur simultaneously.

20. Investment instruments used to invest temporarily idle cash balances should have which of the following characteristics?

- a. High expected return, low marketability, and a short term to maturity
- b. High expected return, readily marketable, and no maturity date
- c. Low default risk, low marketability, and a short term to maturity
- d. Low default risk, readily marketable, and a long term to maturity
- e. Low default risk, readily marketable, and a short term to maturity

SECTION B

1. 'To be relevant to investors, the profit for the year should include both realized and unrealized gains / losses.' Discuss.

2. 'It is essential that the information in financial statements has a prudent characteristic if the financial statements are to be objective.' Discuss.

3. It is proposed at a stockholders' meeting that the firm slow its rate of payments on accounts payable in order to make more funds available for operations. It is contended that this procedure will enable the firm to expand inventory, which will in turn enable the firm to generate more sales. Comment on this proposal.

4. Jane Parker is going to set up a new business on 1 January 20X1. She estimates that her first six months in business will be as follows:

(i) She will put £150,000 into a bank account for the firm on 1 January 20X1.

(ii) On 1 January 20X1 she will buy machinery £30,000, motor vehicles £24,000 and premises £75,000, paying for them immediately.

(iii) All purchases will be effected on credit. She will buy £30,000 goods on 1 January and will pay for these in February. Other purchases will be: rest of January £48,000; February, March, April, May and June £60,000 each month. Other than the £30,000 worth bought in January, all other purchases will be paid for two months after purchase.

(iv) Sales (all on credit) will be £60,000 for January and £75,000 for each month after. Customers will pay for the goods in the fourth month after purchase, i.e. £60,000 is received in May.

(v) She will make drawings of £1,200 per month.

(vi) Wages and salaries will be £2,250 per month and will be paid on the last day of each month.

(vii) General expenses will be £750 per month, payable in the month following that in which they are incurred.

(viii) Rates will be paid as follows: for the three months to 31 March 20X1 by cheque on 28 February 20X1; for the 12 months ended 31 March 20X2 by cheque on 31 July 20X1. Rates are £4,800 per annum.

(ix) She will introduce new capital of £82,500 on 1 April 20X1.

(x) Insurance covering the 12 months of 20X1 of £2,100 will be paid for by cheque on 30 June 20X1.

(xi) All receipts and payments will be by cheque.

(xii) Inventory on 30 June 20X1 will be £30,000.

(xiii) The net realizable value of the vehicles is £19,200, machinery is £27,000 and premises £75,000.

Required: Cash flow accounting

(i) Draft a cash budget (includes bank) month by month for the period January to June, showing clearly the amount of bank balance or overdraft at the end of each month.

(ii) Draft an operating cash flow statement for the six-month period.

(iii) Assuming that Jane Parker sought your advice as to whether she should actually set up in business, state what further information you would require