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QUESTION 1

In analyzing a company's financial statements, which financial statement would a potential investor primarily use to assess the company's liquidity and financial flexibility?

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

Correct Answer: A

Explanation:

Choice "a" is correct. Liquidity ratios and coverage ratios focus on balance sheet account balances.

Choice "b" is incorrect. Income statement information is primarily used for profitability analysis.

Choice "c" is incorrect. The statement of retained earnings is primarily a reconciliation of the retained earnings account.

Choice "d" is incorrect. The statement of cash flows assesses cash inflows and cash outflows.

QUESTION 2

ABC Corp. failed to accrue warranty costs of \$50,000 in its December 31, 1992, financial statements. In addition, a \$30,000 change from straight-line to accelerated depreciation was made at the beginning of 1993. Both the \$50,000 and the \$30,000 are net of related income taxes. What amount should ABC report as prior period adjustments in 1993?

- A. \$0
- B. \$30,000
- C. \$50,000
- D. \$80,000

Correct Answer: C

Explanation: Choice "c" is correct. \$50,000. The cumulative effect of a change in accounting principle is now shown on the retained earnings statement as an adjustment to the beginning balance of retained earnings, assuming that the cumulative effect can be calculated. An exception is made however, for a change in depreciation method, since a change in depreciation method is no longer considered to be a change in accounting principle. A change in depreciation method is now considered to be both a change in method and a change in estimate. These changes should now be accounted for as a change in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings. The correction of the failure to accrue warranty costs is treated as a correction of an error and thus as a prior period adjustment. Choices "a", "b", and "d" are incorrect, per the above explanation.



QUESTION 3

Unless the partnership agreement prohibits it, a partner in a general partnership may validly assign rights to:

	<i>Partnership property</i>	<i>Partnership distributions</i>
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: C

Explanation:

Choice "c" is correct.

Rules: A partner has no right to assign an interest in partnership property because a partner's rights in partnership property are limited to using the property for partnership purposes. However, a partner does have a right to assign her interest in partnership distributions. The assignee does not become a partner, but merely has a right to receive whatever distributions the assignor would have received.

Choices "a", "b", and "d" are incorrect, per the above rules.

QUESTION 4

Which of the following describes how comprehensive income should be reported?

A. Must be reported in a separate statement, as part of a complete set of financial statements.

B. Should not be reported in the financial statements but should only be disclosed in the footnotes.

C. May be reported in a separate statement, in a combined statement of income and comprehensive income, or within a statement of stockholders' equity.



D. May be reported in a combined statement of income and comprehensive income or disclosed within a statement of stockholders' equity; separate statements of comprehensive income are not permitted.

Correct Answer: C

Explanation:

Choice "c" is correct.

Comprehensive income must be presented in one of three formats:

1.

In a combined statement of income and comprehensive income;

2.

In a separate statement of comprehensive income that begins with net income; or

3.

In a statement of changes in equity.

Choices "a", "b", and "d" are incorrect, per the above.

QUESTION 5

What is the underlying concept that supports the immediate recognition of a contingent loss?

A. Substance over form.

B. Consistency.

C. Matching.

D. Conservatism.

Correct Answer: D

Explanation: Choice "d" is correct. Conservatism is a prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered. Recognition of a contingent loss is the recording of an amount representing uncertainty and risk in a business situation. SFAC 2, SFAS 5 para. 82 Choice "a" is incorrect. The substance over form concept presumes that the transaction form may not dictate the accounting treatment. Choice "b" is incorrect. Consistency is conformity from period to period with unchanging policies and procedures. SFAC 2 Choice "c" is incorrect. The matching principle dictates that expenses be matched with the related revenues generated or the time period in which the expense is incurred and known. SFAS #5 cites matching as the one concept supporting the immediate recognition of a contingent loss, but it is not the primary underlying concept. SFAS 5 para. 76