TT TEXTBOOK TESTBANKS

# Test Bank for Financial Reporting Financial Statement Analysis and Valuation 10th Wahlen

TEST BANK SAMPLE PREVIEW

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**Chapter 01: Overview of Financial Reporting, Financial Statement Analysis, and Valuation**

**Multiple Choice**

1. The tools for studying industry economics does **not** include:
   a. Value chain analysis
   b. Classification using Porter's five forces
   c. Classification of cash flows
   d. Economic attributes framework

*ANSWER:* c

2. Which of the following is a question an analyst would ask when assessing the quality of a firm's financial statements?
   a. Are the company's products designed to meet a specific market segment?
   b. Has the firm integrated forward into retailing to final consumers?
   c. Is the firm diversified across several geographical markets?
   d. Do earnings include nonrecurring gains or losses?

*ANSWER:* d

3. Which of the following economic characteristics is consistent with a grocery store chain?
   a. Minimal competition
   b. Extensive competition
   c. High net income to sales
   d. Differentiated product

*ANSWER:* b

4. On a common size basis, which of the following assets is normally largest for an electric utility?
   a. Accounts receivable
   b. Inventory
   c. Property, Plant and Equipment
   d. Cash and Marketable Securities

*ANSWER:* c

5. On a common size basis, which of the following assets is normally largest for a commercial bank?
   a. Accounts and Notes Receivable
   b. Inventory
   c. Property, Plant and Equipment
   d. Cash and Marketable Securities

*ANSWER:* a

6. Which of the following is **not** one of Porter's five forces?
   a. Buyer Power
   b. Supplier Power
   c. Threat of Regulation
   d. Threat of Substitutes

*ANSWER:* c

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7. When assessing buyer power using Porter's five forces, which of the following is **not** consistent with low buyer power?
   a. Brand loyalty
   b. Control of distribution channel
   c. Large number of suppliers
   d. Low price

*ANSWER:* c

8. The second step in financial statement analysis is to identify the company strategy. Which of the following is a question an analyst should ask when performing a strategy analysis?
   a. Are industry sales growing rapidly or slowly?
   b. Do earnings include revenues that appear mismatched with the business model employed by the firm?
   c. Does the industry include a large number of firms selling similar products?
   d. What is the company's degree of geographical diversification?

*ANSWER:* d

9. The third step in financial statement analysis is to assess the quality of the firm's financial statements. Which of the following is a question an analyst should ask when performing this step?
   a. Are industry sales growing rapidly or slowly?
   b. Do earnings include revenues that appear mismatched with the business model employed by the firm?
   c. Does the industry include a large number of firms selling similar products?
   d. What is the company's degree of geographical diversification?

*ANSWER:* b

10. An example of an intangible asset is:
   a. A patent
   b. Land
   c. Investment in another company
   d. Raw material inventory

*ANSWER:* a

11. Which of the following would **not** appear as a liability on the balance sheet?
   a. A labor contract
   b. A note due to a bank
   c. Salary due employees at year-end
   d. Accounts payable

*ANSWER:* a

12. Which of the following assets would appear on the balance sheet at an amount greatly below its fair market value?
   a. Inventory
   b. Marketable securities
   c. Equipment
   d. Brand name

*ANSWER:* d

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13. The accrual basis of accounting recognizes:
    a. Revenue when cash is received from customers
    b. Expenses when paid
    c. Revenue when all or a substantial portion is performed
    d. Revenue when contracts are signed

*ANSWER:* c

14. Which of the following is **not** an activity reported in the Statement of cash Flows?
    a. Operating
    b. Investing
    c. Manufacturing
    d. Financing

*ANSWER:* c

15. The cash basis method of accounting can be best described as:
    a. The recording of transactions and adjustments so that debits equal credits.
    b. The method that equates assets with liabilities and owners' equity.
    c. The method that recognizes revenue when money is received and expenses when money is paid.
    d. The method that matches incurred expenses with related revenues when they are earned.

*ANSWER:* c

16. A value chain for an industry sets forth:
    a. The layers of management the needed to be successful
    b. Sequence of activities involved in the creation, manufacture, and distribution of its products.
    c. Sequence of activities involved in a firm's research and development activities.
    d. Whether the industry is horizontally or vertically integrated.

*ANSWER:* b

17. Which of the following economic characteristics is consistent with a commercial bank?
    a. Low barriers to entry.
    b. High levels of research and development.
    c. Low profit margin on lending activities.
    d. Low profit margin on fee-based financial services, such as merger consulting.

*ANSWER:* c

18. Which of the following economic characteristics is consistent with a pharmaceutical company?
    a. Low barriers to entry.
    b. High levels of research and development.
    c. Low profit margins.
    d. Low business risk.

*ANSWER:* b

19. Which of the following economic characteristics is consistent with a grocery store chain?
    a. Low barriers to entry.

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b. High levels of research and development.
c. High profit margins.
d. Low capital intensity.

*ANSWER:* a

20. When attempting to identify the economic characteristics of the industry in which a particular firm participates an analyst might ask which of the following questions?

a. Does technological change play an important role in the firm maintaining a competitive advantage?
b. Has the firm diversified across several geographic markets?
c. Has the firm recognized revenues at the proper time?
d. Has the firm structured transactions to make it look more profitable than economic conditions suggest?

*ANSWER:* a

21. Which of the following would **not** inhibit new entrants into a market?

a. Existing technological expertise.
b. Large required capital investment.
c. Lack of rivalry among current participants.
d. Existing patented technology.

*ANSWER:* c

22. Current assets are defined as:

a. Cash and cash equivalents.
b. All assets expected to be quickly used by the firm.
c. Cash and other assets that the firm expects to sell or consume during the normal operating cycle of a business, usually one year.
d. Cash and other assets that the firm expects maintain for a period including the normal operating cycle of a business, usually one year.

*ANSWER:* c

23. Which of the following is **not** an expense of a business?

a. Depreciation
b. Dividends
c. Salaries
d. Advertising

*ANSWER:* b

24. Which of the following is **not** a characteristic of an extraordinary item?

a. Material in amount.
b. Nonrecurring.
c. Unusual given the nature of the firm's activities.
d. Requires a cash outflow.

*ANSWER:* d

25. Which of the following activities is an operating activity?



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a. Collections of accounts receivable.
b. Investing in equity securities of other companies.
c. Payment of dividends.
d. Issuing common stock

*ANSWER:* a

26. What is the principal activity of security analysts?
a. To assign credit ratings.
b. To apply IFRS adjustments.
c. To value firms.
d. To assess the need for audits.

*ANSWER:* c

27. All of the following are the building blocks for financial statement analysis **except**:
a. Targeting growth opportunities that diversify exchange rates, risk exposure, and political uncertainty.
b. Describing strategies that a firm pursues to differentiate itself from competitors in order to evaluate competitive advantages, sustainability of the firm's earnings, and its risks.
c. Evaluating the financial statements, including the accounting concepts and methods that underlie them and the quality of the information they provide
d. Identification of the economic characteristics of the industries and the relation of those economic characteristics to the various financial statement ratios.

*ANSWER:* a

28. Which strategy is used when a firm is attempting to create unique products or services for particular market?
a. A quality strategy
b. A low-cost leadership strategy
c. A vertical integration strategy
d. A product differentiation strategy

*ANSWER:* d

29. The following steps make up the steps in financial statement analysis:

1. Identify the strategies the firm pursues to gain and sustain a competitive advantage.
2. Analyze the current profitability and risk of the firm using information in the financial statements.
3. Value the firm.
4. Identify the economic characteristics and competitive dynamics of the industry in which a particular firm participates.
5. Assess the quality of the firm's financial statements and, if necessary, adjust them for such desirable characteristics as sustainability or comparability.
6. Prepare forecasted financial statements.

Which of the following is the proper order for these interrelated sequential steps?
a. 4,1,5,2,6,3
b. 1,2,3,4,5,6
c. 4,6,2,5,1,3
d. 1,4,2,5,3,6



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*ANSWER:* a

30. All of the following are reasons that pharmaceutical companies have higher barriers for entry than grocery stores **except**:
    a. There is lengthy government testing and approval required.
    b. Research and development is a lengthy and uncertain process.
    c. Patent protection is needed for exclusive rights.
    d. The largest asset is typically capital intensive Property, Plant and Equipment.

*ANSWER:* d

31. Which forces typically represent vertical competition in a value chain?
    a. Potential entry and substitutes.
    b. Buyer power and rivalry among existing firms
    c. Supplier power and potential entry.
    d. Buyer power and supplier power

*ANSWER:* d

32. Which forces typically represent horizontal competition in a value chain?
    a. Rivalry among existing firms and supplier power.
    b. Potential entry and buyer power.
    c. Substitutes and potential entry.
    d. Buyer power and supplier power.

*ANSWER:* c

33. Which of the following is an independent entity comprising 15 members and a full-time professional staff that specifies acceptable accounting principles known as IFRS?
    a. FASB
    b. IASB
    c. SEC
    d. GAAP

*ANSWER:* b

34. Which two organizations are working together to harmonize financial reporting worldwide?
    a. FASB and IASB
    b. GAAP and FASB
    c. SEC and FASB
    d. EU and SEC

*ANSWER:* a

35. Which of these would be considered Property, Plant, and Equipment?
    a. Trademark
    b. Office Building
    c. Patent
    d. Goodwill

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*ANSWER:* b

36. Extraordinary gains and losses arise from events that have all the following characteristics **except**:
    a. They are unusual given the nature of the firm's activity.
    b. They are nonrecurring.
    c. They are material in amount.
    d. They result from terminated involvement in a line of business.

*ANSWER:* d

37. Opinions on the effectiveness of the internal control system and the fairness of the amounts reported in the financial statements are known as:
    a. Management Discussion and Analysis.
    b. Assurance Opinions.
    c. Notes to the Financial Statements
    d. Management Assessments.

*ANSWER:* b

38. Which SEC form may be the best place to start learning about the economics of an industry and the particular strategy a firm has selected for competing in the industry?
    a. Form 8-K
    b. Form 10-K
    c. Form MD&A
    d. Form FSAP

*ANSWER:* b

39. The primary purpose of the balance sheet is to:
    a. Report the current value of the business.
    b. Measure the net income of a business up to a particular point in time.
    c. Report the difference between cash inflows and cash outflows for the period.
    d. Report the financial position of the reporting entity at a particular point in time.

*ANSWER:* d

40. Which financial statement would you look at to determine whether a company will be able to pay for the goods when payment is due in 30 days?
    a. Statement of cash flows.
    b. Statement of stockholders' equity.
    c. Income statement.
    d. Balance sheet.

*ANSWER:* d

41. Which of the following is **not** considered to be a liability?
    a. Wages payable.
    b. Accounts payable.
    c. Notes payable.

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d. Cost of goods sold.

*ANSWER:* d

42. Assets for a particular business might include:

a. Cash, retained earnings, and accounts payable.

b. Cash, common shareholders’ equity, and accounts receivable.

c. Cash, property, plant, and equipment, and accumulated other comprehensive income.

d. Cash, inventories, and goodwill.

*ANSWER:* d

43. The two categories of shareholders' equity usually found on the balance sheet of a corporation are:

a. Contributed capital and property, plant, and equipment.

b. Retained earnings and notes payable.

c. Common stock and retained earnings.

d. Contributed capital and equity securities.

*ANSWER:* c

44. Which financial statement for a business would you look at to determine the company's earnings performance during an accounting period?

a. Balance sheet.

b. Income statement.

c. Statement of cash flows.

d. The Management Assessment.

*ANSWER:* b

45. Accounts payable represent:

a. Amounts which are due to stockholders.

b. Amounts which have been borrowed to finance operations.

c. Amounts which are owed to the company by its customers resulting from credit sales.

d. Amounts which are owed by the company to its suppliers for past purchases.

*ANSWER:* d

46. On the statement of cash flows, depreciation would be classified as?

a. A financing activity.

b. An operating activity.

c. An investing activity.

d. A noncash activity.

*ANSWER:* b

47. Which form does the balance sheet equation take in the United Kingdom?

a. Noncurrent Assets + Noncurrent Liabilities = Shareholders’ Equity

b. Revenues - Expenses = Shareholders’ Equity

c. Noncurrent Assets + [Current assets - Current Liabilities] - Noncurrent Liabilities = Shareholders’ Equity

d. Noncurrent Assets - Current assets = Noncurrent Liabilities - Current Liabilities + Shareholders’ Equity

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*ANSWER:* c

48. Net income is equal to:
  a. Assets minus Liabilities
  b. Revenues and Gains minus Expenses and Losses
  c. Shareholders' Equity minus Assets
  d. Revenues and Assets minus Expenses and Liabilities

*ANSWER:* b

49. All of the following are principal provisions of the Sarbanes-Oxley Act of 2002 **except**:
  a. At least one member of the audit committee of the board of directors must be a "financial expert."
  b. The lead audit or coordinating partner and the reviewing partner of the public accounting firm must rotate, or change, every five years.
  c. The firm's chief executive officer and the chief financial officer must issue a statement along with the audit report stating that the financial statements and notes fairly present the operations and financial position of the firm.
  d. The FASB has oversight and enforcement authority over the SEC.

*ANSWER:* d

50. Why is the operating activities section of the statement of cash flows often believed to be the most important part of the statement?
  a. Because it shows the dividends that have been paid to stockholders.
  b. Because it indicates a company's ability to generate cash from sales to meet current cash payments for goods or services.
  c. Because shows the net increase or decrease in cash during the period.
  d. Because it gives the most information about how operations have been financed.

*ANSWER:* b

51. The tools of effective financial statement analysis are useful for assessing whether to extend ______ to a firm, either for a short-term or for a long-term. *Select the best term to complete the sentence.*
  a. debit
  b. credit

*ANSWER:* b

52. The Second step in financial statement analysis requires businesses to analyze strategies that will ______ itself from the firms' competitors. *Select the best term to complete the sentence.*
  a. associate
  b. differentiate

*ANSWER:* b

53. Another important step in financial statement analysis is to assess the quality of a firm's ______ and if necessary adjust them for such characteristics as sustainability or comparability. *Select the best term to complete the sentence.*
  a. financial statements
  b. bank statements
  c. marketing plans

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*ANSWER:* a

54. The fourth step in financial statement analysis is using the financial statements to analyze the current profitability, growth and ______ of the firm. *Select the best term to complete the sentence.*
    a. size
    b. risk

*ANSWER:* b

55. When identifying the strategies that a particular firm pursues to gain a competitive advantage it is important to determine if its products are designed to meet the needs of a specific market segment or are they intended for a ______.
    a. broader consumer market
    b. specific customer

*ANSWER:* a

56. The ______ sets forth the sequence of activities involved in the creation, manufacture and distribution of its products and services. *Select the best term to complete the sentence.*
    a. sales to cash cycle
    b. value chain

*ANSWER:* b

57. The higher the value added from any activity, the higher should be the ______ from engaging in that activity. *Select the best term to complete the sentence.*
    a. cost
    b. profitability

*ANSWER:* b

58. Normally, intense rivalries have a tendency to reduce ______.
    a. value
    b. profitability

*ANSWER:* b

59. The threat of new entrants is measured by whether there are entry barriers, such as capital investment, ______, patents, or regulation that inhibit new entrants. *Select the best term to complete the sentence.*
    a. labor shortages
    b. technological expertise

*ANSWER:* b

60. The five economic attributes that are normally studied are demand, supply, manufacturing, ______, and investing and financing. *Select the best term to complete the sentence.*
    a. marketing
    b. sustainability

*ANSWER:* a

61. Obtaining a competitive advantage by being the first company to introduce new concepts or ideas is referred to as ______.
    a. first mover advantage



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b. price leader advantage

*ANSWER:* a

62. Resources that have the potential for providing a firm with future economic benefits are called ______.

a. assets

b. liabilities

*ANSWER:* a

63. Cash and cash equivalents are considered ______ assets. *Select the best term to complete the sentence.*

a. Intangible

b. Monetary

*ANSWER:* b

64. ______ assets include the rights established by law or contract to the future use of property. *Select the best term to complete the sentence.*

a. Monetary

b. Intangible

*ANSWER:* b

65. Labor contracts and purchase order commitments are examples of ______ contracts. *Select the best term to complete the sentence.*

a. executory

b. fixed

*ANSWER:* a

66. The main components that make up the stockholder's equity section of the balance sheet are retained earnings and ______.

a. common stock

b. notes payable

*ANSWER:* b

67. Under the ______ basis of accounting, a firm recognizes revenue when it performs all or a substantial portion, of the services it expects to perform and receives either cash or a receivable. *Select the best term to complete the sentence.*

a. accrual

b. cash

*ANSWER:* a

68. ______ equals net income for a period plus or minus the changes in shareholders' equity accounts other than from net income and transactions with owners. *Select the best term to complete the sentence.*

a. Comprehensive income

b. Earnings per share

*ANSWER:* a

69. Statements that express all items in a particular financial statement as a percentage of some common base are called ______ statements. *Select the best term to complete the sentence.*

a. common size

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b. income

*ANSWER:* a

70. Depreciation is a ______ added back to net income when preparing the operating activities section of the Statement of Cash Flows. *Select the best term to complete the sentence.*

a. Cash expenditure

b. Non-cash expenditure

*ANSWER:* b

71. The ______ defines more clearly the explicit responsibility of managers for financial statements, the relation between the independent auditor and the firm audited and the kinds of services permitted and not permitted. *Select the best term to complete the sentence.*

a. Financial Accounting Standards Board

b. Sarbanes-Oxley Act of 2002

*ANSWER:* b

72. Under the Sarbanes-Oxley Act ______ assumes responsibility for establishing and maintaining adequate internal control structure and procedures. *Select the best term to complete the sentence.*

a. auditors

b. management

*ANSWER:* b

73. Most financial statement analysis aims to assess a firm's profitability and ______.

a. ability to produce products

b. risk

*ANSWER:* b

74. ______ financial statements are helpful in highlighting the relative magnitude of changes in financial statement data from year to year. *Select the best term to complete the sentence.*

a. Stand alone

b. Percentage change

*ANSWER:* b

75. Basic EPS is calculated as net income minus ______ divided by the weighted average number of shares outstanding. *Select the best term to complete the sentence.*

a. taxes

b. dividends on preferred stock

*ANSWER:* b

76. The prospectus must be filed with the ______ before the company can sell new issues of stocks or bonds. *Select the best term to complete the sentence.*

a. FASB

b. SEC

*ANSWER:* b

77. ______ relates to the relative number of buyers and sellers in a particular industry. *Select the best term to complete the*



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*sentence.*

a. Buyer power

b. Supply chain

*ANSWER:* a

78. How easily can new firms enter a market is a question one might ask when assessing ______.

a. threat of entrants

b. threat of substitutes

*ANSWER:* a

79. How easily can customers switch to substitute products is a question one might ask when assessing the ______.

a. threat of entrants

b. threat of substitutes

*ANSWER:* b

80. Nonmonetary assets include assets that are tangible, such as inventories, and assets that are intangible such as _________.

a. brand names

b. cash

c. equipment

d. investments

*ANSWER:* a

**Subjective Short Answer**

81. What are the six interconnected activities related to financial statement analysis?

*ANSWER:*

1. Identify the economic characteristics of the industry in which a firm participates.
2. Identify the strategies that a particular firm pursues to gain and sustain a competitive advantage.
3. Assess the quality of a firm's financial statements and, if necessary, adjust them for such desirable characteristics such as sustainability or comparability.
4. Analyze the current profitability and risk of the firm using information in the financial statements.
5. Prepare forecasted financial statements.
6. Value the particular firm.

82. What is an industry's value chain?

*ANSWER:*

An industry's value chain is the sequence of activities involved in the creation, manufacture and distribution of its products and services.

83. Identify Porters' Five Forces?

*ANSWER:*

1. How easily can new firms enter the market? Rivalry among existing firms
2. Do new firms require a large capital investment? Threat of new entrants
3. Do new firms require large amounts of technological expertise? Threat of substitutes
4. Does regulation inhibit new firms from entering the market? Buyer Power

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5. Supplier Power

84. What three financial statements are prepared by business firms and what information does each provide?
*ANSWER:*
1. Balance sheet--Point in time reporting of assets, liabilities and stockholders' equity.
2. Income statement--Measurement of operating performance for a period of time.
3. Statement of cash flows--The net cash flows for a period of time from the three business activities: operating, investing and financing.

85. Many people view the balance sheet as being a representation of a firm's economic position. What are some issues that reduce the quality of this representation?
*ANSWER:*
1. Many valuable resources of a firm that generate cash flows, such as a patent, will only appear as assets if acquired, not when they are internally developed.
2. Nonmonetary assets appear at acquisition cost, even though their current market values might exceed acquisition cost.
3. Certain rights to use resources and commitments to make future payments may not appear as assets and liabilities.
4. Noncurrent liabilities appear at the present value of expected cash flows discounted at an interest rate determined when the liability arose, not at the current rate.

86. Under the Sarbanes-Oxley Act of 2002, financial statements must include both a Management Assessment and an Assurance Opinion. What information do the Management Assessment and an Assurance Opinion provide to financial statement users?
*ANSWER:*
The *Management Assessment* makes explicit management's responsibility for not only the financial statements but for the underlying accounting and control system that generates the financial statements.

The *Assurance Opinion* is provided by the independent auditor and is included with the opinion on the fairness of the amounts reported in the financial statements. The *Assurance Opinion* provides the auditor's opinion on the effectiveness of the internal control system.

87. What are three activities reported in the statement of cash flows and what information does each activity provide?
*ANSWER:*
1. Operating activities - Provides information on cash generated and used by a firm in its normal activities of selling goods and providing services.
2. Investing activities - Provides information about the firm's use of cash in the acquisition of long-lived productive assets and cash provided by the disposal of long-lived productive assets. In addition, cash provided and used by investment in debt and equity securities are included in this category.
3. Financing activities - Provides information about cash provided and used by short- and long-term borrowing and from issuing or repurchasing capital stock. In addition, cash used for dividends is reported in this category.

88. What is comprehensive income?
*ANSWER:*
Comprehensive income equals net income for a period plus or minus the changes in shareholders' equity accounts other than from net income and transactions with owners. Items affecting comprehensive income include foreign currency translation adjustments, cash flow hedge accounting, minimum pension liability adjustments and unrealized gains and losses from holding investment securities classified as available for sale.

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89. What is the rationale for the statement of cash flows?

*ANSWER:*

The statement of cash flows provides information on the sources and uses of cash. Even profitable firms sometimes find themselves in need of cash and unable to pay suppliers, employees, and other creditors. This may occur for two reasons:

1. The timing of cash receipts from customers does not necessarily coincide with the recognition of revenue, and the timing of cash expenditures does not necessarily coincide with the recognition of expenses under the accrual basis of accounting.

Normally cash expenditures precede the recognition of expenses and cash receipts occur after the recognition of revenue.

10. The firm may need to acquire new property, plant, and equipment; retire outstanding debt; or reacquire shares of its common stock when there is insufficient cash available.

90. Describe what is meant by income from continuing operations?

*ANSWER:* Income from continuing operations represent all of the cash inflows (sales) and the cash outflows (expenses) that are normally recurring in the daily operations of the company.

91. When a company sells a subsidiary or a product line on what financial statement is it reported and how is it reported?

*ANSWER:* The sale of a company's subsidiary or a product line is reported on the income statement as a gain or loss from discontinued operations and is reported net of applicable income taxes.



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