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Financial Literacy Quiz

1. **Who is responsible for the proper preparation and presentation of the financial statements?**
   a. Board of Directors
   b. Management
   c. External auditor
   d. Audit Committee

2. **What is the purpose of private meetings between the audit committee and the auditors, both external and internal?**
   a. Facilitate private evaluation of the CFO
   b. Allow the auditors to express concerns to the committee without management present
   c. Allow the audit committee to press the external auditors for lower fees
   d. Reinforce the independence of the committee to the management team

3. **Deferred taxes are:**
   a. The unpaid portion of the company's current tax bills
   b. Taxes resulting from the difference between GAAP (book) income and taxable income
   c. Tax obligations that arise solely from the implementation of tax shelter vehicles
   d. Taxes resulting from the difference between the GAAP and tax carrying amounts of the assets and liabilities

4. **Illegitimate earnings management practices include:**
   a. Over-accruing restructuring costs in one period and reversing those charges into income in future periods
   b. Building up various liability accounts (by accruing more expenses) in good quarters and decreasing them in bad quarters
   c. Recording revenue before the products or services have been delivered
   d. Postponing the recognition of revenue into future quarters even though the firm has completed its earnings cycle
   e. All of the above

5. **Who is responsible for hiring and firing the external auditor?**
   a. Chief Financial Officer
   b. Audit Committee
   c. Chairman of the Board, with the advice of the CEO
   d. The Board, having usually delegated the task to the audit committee
   e. The shareholders, by vote on the proxy statement

6. **Which of the following is NOT typically included among "current assets" on the balance sheet?**
    a. Accounts receivable
    b. Fixed assets
    c. Inventory
    d. Prepaid expenses
    e. All of the above are typically included

7. **What is the common definition of "current liabilities"?**
    a. Company obligations that must be paid in cash
    b. Company obligations to current vendors and suppliers
    c. Company obligations that become due within 90 days
    d. Company obligations that become due within a year

8. **What are the three sections of the cash flow statement?**
    a. Cash from operations, investing activities and financing activities
    b. Cash from operations, working capital and capital expenditures
    c. Cash from operations, asset sales and stock activity
    d. None of the above

9. **Examples of impaired assets that would require the company to record a charge over the appropriate upcoming periods include:**
    a. Uncollectible receivables
    b. Equipment used for an abandoned product line
    c. Obsolete inventory
    d. Investments/securities that have declined in value
    e. Goodwill from a bad acquisition
    f. All of the above

10. **The leading cause of financial reporting RESTATEMENTS is:**
    a. The SEC changing the rules requiring retroactive adoption
    b. The FASB/EITF issuing a new rule
    c. Improper revenue accounting
    d. Improper inventory accounting

11. **Companies are required to break out the financial results of their business "segments" and the geographies they operate in. How are "segments" defined?**
    a. By product classification
    b. By industries the company operates in
    c. By the groupings that management uses to report the results internally
    d. By specific SEC definitions of industry segments

12. Which of the following derivatives might potentially be "marked-to-market" in the financial statements:

a. Interest rate swaps
b. Forward commodities contracts
c. Foreign currency options contracts
d. All of the above

13. Gross margin is generally defined as:

a. Revenue less allowances for returns and bad debts
b. Revenues less direct operating costs, usually costs of goods sold
c. Revenues less costs of good sold plus depreciation and amortization
d. None of the above

14. Which of the following best describes the purpose of MD&A (management discussion and analysis) in the financial statements?

a. To report the results in a narrative, not tabular, manner
b. Allow management to give an assessment of its own performance
c. Describe trends and uncertainties in operations and capital resources
d. Give an industry overview

15. A new CEO is hired by the Board of Directors. The new CEO is given a $250,000 relocation allowance that is repayable to the company if she leaves the company within one year of her start date.

a. The company should record a prepaid for the amount and expense it after one year
b. The company should amortize the expense over the first year of employment
c. The company should expense it when paid
d. None of the above

16. A "Statement of Management Responsibility" is:

a. A statement in the annual report, signed by the CEO and CFO, that management is responsible for the financial statements
b. Not required by the SEC
c. Generally found in large company annual reports, but not small company reports
d. Strongly recommended for all companies by Financial Executives International
e. All of the above

17. The major difference between the NYSE and the NASDAQ is:

a. NYSE uses the central agency-auction model
b. NASDAQ uses the central agency-auction model
c. NASDAQ uses the market-maker/dealer-sponsored model
d. There is no difference
e. Both a and c are correct
f. Both a and b are correct

18. The audit committee of a public company should be composed of:

a. The CFO, CEO and at least three outside directors
b. At least three independent directors, all financially literate, and at least one financial expert
c. The CFO, the CEO and the Chairman of the Board
d. None of the above is correct

19. Who should establish the agenda for an audit committee meeting?

a. CFO
b. Outside auditor
c. Audit committee chairperson
d. Chairman of the Board

20. Which of the following is NOT an example of an intangible asset?

a. Patent on unused technology/business know-how
b. A product formula
c. Recent improvements to major facility
d. Goodwill

21. The audit committee of a public company is required to:

a. Give a report that, in its opinion, the financial statements are in compliance with GAAP
b. Meet at least four times a year
c. Oversee all company litigation
d. Disclose whether it considered the impact of consulting work on the auditor's independence

Financial Literacy Quiz Answers

1. B. Management is responsible, and the Board has oversight responsibility.

2. B

3. D. If you answered B, you're out-of-date. The current FASB rules take a balance sheet approach to deferred taxes, not an income statement approach.

4. E. All of these practices are targeted by the SEC's earnings management initiative.

5. D

6. B. Current assets are generally assets that will be converted into cash within a year (or one normal business cycle). Fixed assets (equipment, plant) are usually long-term in nature.

7. D. The ratio of current assets to current liabilities is important for the ongoing liquidity of the company. Generally, a ratio of 1:1 is considered healthy.

8. A. Understanding these three sections and thinking about the future of the business in terms of the cash flow from operations, investments and financing are a great way to assess a business. This is a very important part of the financial statement to investors.

9. F

10. C. If there is one area to focus on and urge conservative accounting for, it's revenue recognition. Again and again, for many years, this has been the number one problem area.

11. C. This is the biggest current hot button for the SEC. Investors want to know how the management team looks at the business and how those pieces are performing.

12. D

13. B. Gross margins are hugely important to financial statement readers. Odd trends and shifts in percentage gross margins usually have major implications.

14. C. MD&A is too often a boilerplate regurgitation of the numbers. This is not the intent. It should be analytical and forward-looking. SEC reviews almost always hammer away on this point.

15. C. There might be an argument for B, but it would be tough to prove and represents aggressive accounting.

16. E. Most big companies do this, and it is good discipline for the operating management to acknowledge its responsibility to the shareholders.

17. E. This is seemingly an obscure question, which involves understanding the difference between the two market methods and which is best for your shareholders (trading efficiencies and depth of market issues), can save your shareholders a lot of money and facilitate capital-raising. Neither model is better -- one just may be more applicable for different situations.

18. B. That's why you're taking this quiz.

19. C. Too many audit committees let the auditor or CFO run the agenda. Don't fall into that trap. Be active and a leader.

20. C

21. D. The SEC has put a big emphasis on auditor independence and complications resulting from the growth of the public accounting firms' consulting practices.