Chapter 1

The Accounting Profession: An Overview

LEARNING OBJECTIVES

- Be able to define accounting (distinguish between managerial and financial accounting)
- Understand that there exists a basic accounting rule-making process nationally and internationally
- Exposure to names and descriptions of basic financial statements
- Exposure to the basic accounting equation (*assets = liabilities + equity*)
- Exposure to methods used to maintain integrity of accounting information (audit reports, regulations, internal control systems, professional rule makers, corporate governance, and the education, experience, and ethical considerations of accountants and auditors)
- Exposure to accounting career opportunities

1.1 Accounting Described

Accounting is the international language of business. A distinction is often made between *managerial accounting* and *financial accounting*.

Managerial accounting refers to the preparation of financial information used chiefly by managers of a business entity in decision-making. The emphasis is on future courses of action that management might take. For example, managerial accounting information may be used to determine which product lines should be manufactured or dropped from production, which divisions or departments are meeting goals (target profits, sales levels, return on investment requirements), and a host of other decisions related to performance. This information may be prepared in whatever manner management wants it prepared for decision-making purposes.

Financial accounting, which is the focus of this textbook, refers to the creation of financial information used chiefly by creditors, potential creditors, investors, and potential investors. Financial accounting provides historical information regarding a firm's financial position, results of operations, and cash flows. Other external users of financial accounting information include governmental agencies, labor unions, suppliers, customers, and the general public. Of course, management may use this information too but it is designed for consumption chiefly by outsiders. This information must be prepared in a specific manner. That is, in the United States, financial accounting information is prepared in accordance with generally accepted accounting principles (GAAP) as promulgated currently by the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB). The International Accounting Standards Board (IASB) promulgates international accounting standards which have been adopted by many countries and may be adopted in the United States, in whole or in part, at some point in the future.

1.2 More on the Rule Makers

The SEC is a governmental agency that reviews the financial information of public companies (companies that trade their stocks publicly) for compliance with GAAP and it may take legal action against companies that are not in compliance with GAAP. The SEC is the only body which can adopt accounting principles that become law through Congressional action, but the SEC usually adopts the FASB's standards.

The FASB is a private sector, independent professional organization (not a governmental agency) which is the primary source of GAAP in the U.S.A. at this time. The FASB began in 1973. Before that, GAAP was established first by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants (AICPA) (1936–1959) and then by the Accounting Principles Board, also a part of the AICPA (1959–1973). In part to assure greater independence, separating rule-making bodies from the AICPA, the FASB was created. The FASB once promulgated official statements on GAAP using mainly *Statements on Financial Accounting Standards* (SFASs). Other FASB pronouncements included *Statements of Financial Accounting Concepts, FASB interpretations, FASB Staff Positions*, and *FASB Technical Bulletins*. Note: There are other rule-making bodies in the U.S.A. For example, the Governmental Accounting Standards Board (GASB) promulgates GAAP for state and local governments. In July of 2009, the FASB launched the *FASB Accounting Standards Codification* as the official single source of authoritative nongovernmental U.S. GAAP, which has greatly enhanced any research of U.S. GAAP issues. As a result, SFASs are no longer issued and the FASB now votes on final draft GAAP proposals after discussion by interested parties in academe, industry, and the accounting profession. If approved by a majority of the FASB's seven-member board, an *Accounting Standards Update* (ASU) is issued for inclusion in the *FASB Accounting Standards Codification* as U.S. GAAP.

Cross-border business activity has been increasing for decades, including the purchase and sale of goods and services, as well as the purchase and sale of investment securities. Since many countries have their own GAAP, differences in reporting standards make financial statement comparability quite difficult. Excessive financial reporting costs result when a company is forced to prepare financial statements in two or more countries using different financial reporting standards. Through the use of international standards, greater financial statement comparability may be achieved and the cost of preparing financial information may be minimized. The development of international financial reporting standards was a natural consequence of increased global trade and investment.

The International Accounting Standards Committee (IASC) from 1973 to 2001 originally issued International Accounting Standards (IAS) in an attempt to harmonize accounting and reporting across the European Union. As the concept of international accounting standards became more attractive globally, providing greater financial statement comparability and lower financial reporting costs, in 2001 the new International Accounting Standards Board (IASB) was created. The IASB replaced the IASC as the entity responsible for setting international accounting standards. The IASB initially adopted existing IAS and also began to promulgate new standards called International Financial Reporting Standards (IFRS), as well as interpretations of IFRS. According to the IFRS website, the primary mission of the IFRS Foundation "is to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRS) based upon clearly articulated principles." (See www.ifrs.org at "About Us"). The IASB and the FASB have developed a joint conceptual framework that articulates the objective of financial reporting as providing information that is useful to investors and creditors in decisions about providing resources to a firm. Such financial reporting includes the *fundamental qualitative characteristics of relevance and faithful representation*. Relevance refers to information that helps users make decisions by confirming or predicting value. Relevant information is information that is materially fairly stated. (The concept of materiality is entity (firm) specific. An item is material if it influences the decisions of financial statement users.) Faithfully represented information is information that is complete, relatively error free, and presented without bias.

Accounting information must also have *enhancing qualitative characteristics* including:

- *Comparability* (Financial information of one company must be capable of being compared with another company's financial information, as well as with the same company's financial information for a different accounting period. Consistent use of the same accounting principles by a company from one year to the next is one way of achieving comparability.)
- *Verifiability* (Information should be directly or indirectly verifiable by independent knowledgeable parties, representing what it purports to represent.)
- *Timeliness* (Information should be available in time to influence decision making.)
- *Understandability* (Information must be clear enough to allow investors and creditors who use it to be reasonably informed users.)

Financial reporting constraints are also a part of the conceptual framework. A primary constraint in financial reporting is cost. The cost of providing financial information cannot exceed the benefit of that information to users of financial information. Other constraints include common industry practice and conservatism (the concept of conservatism is addressed in chapter 2).

The European Union (EU) requires its member nations to use IASB standards, as do many nations outside of the EU. The SEC accepts foreign company financial statements prepared using IASB standards. The role of the FASB will likely change dramatically in the future as the role of the IASB increases both internationally and within the U.S.A. But there are reporting differences that the IASB and the FASB are working together to eliminate or mitigate. A fundamental problem is that the FASB is "rules-based" while the IASB is "principles-based" in their pronouncements.

Exhibit 1.1

FASB (U.S. GAAP) vs. IASB (IFRS) Basic Conceptual Comparison

FASB (U.S. GAAP)	IASB (IFRS)
FASB (U.S. GAAP) → rules-based	IASB (IFRS) → principles-based
FASB (U.S. GAAP) → less judgment required in application of rules	IASB (IFRS) → more judgment required in application of principles
FASB (U.S. GAAP) → more detailed	IASB (IFRS) → less detailed

Rules-based reporting involves relatively less judgment than principles-based reporting. In a court of law, it is easier to defend a financial reporting method based on a hard and fast rule than on a principle involving interpretation and judgment. Therefore, shifting from a rules-based approach in the U.S.A. to a principles–based approach has certain legal ramifications that have caused some parties to criticize the use of IASB

standards for fear of unfavorable legal action. But, as mentioned earlier, cost and comparability issues are likely to trump everything else and lead to adoption (or at least partial adoption) of international standards at some point. As the IASB and the FASB continue to work together toward convergence, adoption of a single set of global standards, the principal benefit of which would be increased international capital flow, has become more likely.

This textbook emphasizes the use GAAP as defined by the FASB, but includes remarks at points where there may be differences between the FASB and the IASB standards.

1.3 The Basic Financial Statements

Financial statements are representations in a currency (dollars, euros, yen, etc.) of a business entity's financial performance. There are three basic financial statements:

1) *Income statement*: The income statement shows the net income (excess of revenue from sales of products or services over expenses such as salary, rent, insurance, taxes, etc.) or loss (excess of expenses over revenues) ***for a period of time*** such as a year, quarter, or month. If for the year ended December 31, 20X9, a company had revenues of $1,000,000 and expenses of $800,000, it would have net income of $200,000.

2) *Statement of Financial Position (or Balance Sheet)*: The balance sheet shows a company's assets ***as of a specific date*** (not for a period of time) and how these assets are financed, using liabilities or owners' equity. Assets are economic resources with future benefit that are available to a company (cash, land, equipment, buildings, etc.). Liabilities are debts. Owners' equity represents the owners' share of interest in the assets. A firm's assets could have been financed using borrowed funds (liabilities) or cash (owners' equity). The statement of financial position will show this relationship. For example, if as of December 31, 20X9, a company has $10,000,000 in assets and total debt of $6,000,000, this would imply that $4,000,000 worth of the assets is owned by the company's owners (known as owners' equity). We have now reached a point at which the basic accounting equation may be presented as follows:

ASSETS	=	LIABILITIES	+	OWNERS' EQUITY
$10,000,000	=	$6,000,000	+	$4,000,000

You will see this equation, which is a simple but fundamental part of accounting theory, a great deal in this textbook. With minor adjustment, the equation can be re-written to define owners' equity mathematically as follows:

ASSETS	–	LIABILITIES	=	OWNERS' EQUITY
$10,000,000	–	$6,000,000	=	$4,000,000

The owner(s) of a firm could be sole proprietors, partners, or shareholders depending upon whether a business is organized as a sole proprietorship, partnership, or corporation respectively. These different business forms will also be discussed in greater detail later.

3) *Statement of Cash Flows*: The statement of cash flows shows, in some detail, what caused a change in cash (increase or decrease) ***for a period of time*** such as a year, quarter, or month. If a company had $3,000,000 in cash on January 1, 20X9 and $4,000,000 in cash on December 31, 20X9, the statement of cash flows would not only show that cash had increased by $1,000,000, but it would show the sources and uses of cash that led to the net increase.

These are simplistic descriptions of the three basic financial statements. These financial statements will be presented in much greater detail throughout the textbook. You will learn how these statements are prepared and how to interpret the financial information they contain in the next several chapters. For now, suffice it to say that creditors and investors want to know if a company has made a profit (and they can find out using the *income statement*), and they want to know if the company has remained solvent in the process (they can find out using the *statement of cash flows* and the *statement of financial position*).

1.4 Accounting Information Systems

Accounting information systems (AISs), often described as a subset of the more comprehensive Management Information System (MIS), are record keeping systems that provide decision makers with financial information about a business's operations. The AIS processes financial transactions so that: a) internal financial reports can be prepared chiefly for use by managers and, b) external financial reports (such as the three basic financial statements just described) can be prepared chiefly for use by creditors, investors, regulators, and the general public. AISs were once paper based but this is now rare as most AISs use sophisticated accounting software so that decision making can be done in a timely, efficient, and cost effective way. Throughout the text, a manual systems approach is often used but manual systems are generally too slow and cumbersome for modern business needs. However, manual systems convey very well the basic accounting and reporting concepts that are needed in any system, manual or computerized.

1.5 Integrity of Accounting Information

How do you know as an investor or creditor that financial information you receive from a company fairly presents their statement of financial position or income statement (operational results)? There have been numerous financial debacles in recent years and it has put investors and creditors on full alert. The Enron and WorldCom debacles of a few years ago immediately come to mind, as do the more recent problems in the financial community at Lehman Brothers and American International Group, Inc. (AIG).

There are several things investors and creditors expect to become reasonably assured that the financial information they are receiving is fairly presented, such as *financial statement audits*, strong *internal control systems* particularly over financial reporting, and the *appropriate education*, *experience*, *and ethical reflection on the part of financial statement preparers and auditors.*

1.5a *Financial Statement Audits*

First, considerable assurance is often provided through an audit of the company's financial statements. An audit involves testing the financial representations made in the financial statements by management to determine if the financial statements are fairly presented. The audit should be done by a certified public accountant (CPA) who is independent of the company being audited. For example, the CPA auditor should have no direct or material (large) indirect interest in the client under audit. In the U.S.A., auditors will assess the fairness of financial statements on the basis of their adherence to GAAP. Auditors will conduct the audit in accordance with generally accepted auditing standards promulgated by the American Institute of CPAs. However, if an audit of an SEC client company is being done, then the auditor will follow the auditing standards of the Public Company Accounting Oversight Board. The auditor will prepare a report upon completion of the audit which may provide:

a) *an unmodified opinion (formerly termed unqualified opinion)*: This would indicate that in the opinion of the auditor the financial statements and related disclosures fairly present financial information in all material respects in terms of GAAP (or whatever basis of accounting is being used).

b) *a qualified opinion*: This would also indicate that in the opinion of the auditor the financial statements and related disclosures fairly present financial information in all material respects in terms of GAAP (or whatever basis of accounting is being used) *except for* some GAAP or disclosure deficiency. So if, for example, GAAP requires that an asset be reported at its original historical cost but a client chooses to instead use a materially higher fair market value for that asset, then the auditor may have to qualify the opinion.

c) *an adverse opinion*: This would indicate that in the opinion of the auditor the financial statements and related disclosures do not fairly present financial information in all material respects in terms of GAAP (or whatever basis of accounting is being used). This type of opinion should be very rare, especially since a client would first be asked to make adjustments to the financial statements so that they are not materially unfair representations and only upon the client's refusal to make adjustments would an adverse opinion have to be rendered.

d) *a disclaimer of opinion*: A disclaimer is no opinion at all. The auditor would state that no opinion could be rendered on fairness because the scope of the audit was limited in some way. For example, a client might impose restrictions on the audit procedures that an auditor wanted to perform and this would preclude the auditor from rendering an opinion.

By far, unmodified (formerly termed unqualified) opinions are most common.

Exhibit 1.2, which follows, is an example of an unmodified opinion rendered on the financial statements of Wal-Mart Stores, Inc. by Ernst & Young, LLP (independent public accountants). Note that the report is written on the CPA firm's letterhead and should be addressed to the Board of Directors (or a separate independent audit committee of the board) and Shareholders of Wal-Mart Stores, Inc. to assure independence, and *not to the management of the company that prepared the statements* being reported on. The third paragraph of the report which begins with the words "In our opinion…." expresses an unmodified opinion on the financial statements. There is an added fourth paragraph that refers to the auditor's expression an opinion on the internal control system of Wal-Mart Stores, Inc. More information on the concept of internal control will be provided shortly. Congress passed the Sarbanes-Oxley Act (SOX) in 2002 in response to the fraudulent financial reporting of companies like Enron and WorldCom. One of the requirements of SOX is that the management of public companies (SEC filers) must issue an annual report indicating they have an effective internal control system over financial reporting and the external auditor must also render an opinion on internal control effectiveness. SOX also resulted in the creation of the Public Company Accounting Oversight Board (PCAOB), referenced in paragraph 4 of the audit report in Exhibit 1.2, which is charged with promulgating auditing standards for public companies (issuers). *Note*: The AICPA's Clarified Auditing Standards changed the format of the audit report for nonissuers. But the PCAOB's Interim Auditing Standards continue the use of the prior AICPA audit report format (shown in Exhibit 1.2). The basic audit report content is the same under clarified AICPA and PCAOB standards. However, audit report form differences under the AICPA's new format include (a) the use headings within the report to delineate management's responsibility, the auditor's responsibility, and the opinion, and (b) more detailed information on the responsibilities of management and the auditor.

1.5b Internal Control Systems

According to the AICPA's Committee of Sponsoring Organizations of the Treadway Commission, internal control is a process that has as its objectives (a) *the reasonable assurance of reliable financial reporting*, (b) *compliance with laws*, and (c) *effective and efficient operations*. Internal controls are put into effect by the board of directors, management, and other personnel. A so-called "tone at the top" is required at the highest levels of the company which is respectful of the need for strong internal control systems that involve assessing risk that internal control objectives may not be achieved, developing control activities (reconciliations, separation of duties) in any area of risk, and creating strong information, communication, and monitoring systems regarding internal controls. Internal control systems include the following key elements, to mention a few:

- Adequate approval systems and separation of duties: For example, only the sales department may approve sales orders. Only the purchasing department can approve purchase orders. Only the treasury function may write checks. In other words, there should be a separation of the duties of custody, accounting, and authorization. Consider the simple case of a business that allows the same person to collect and deposit cash (cash custody), approve (authorize) the write-off in the financial records (accounting) of an account receivable from a customer. The duties of cash collection and custody should be separate from the accounting and authorization functions. Separation of duties makes it impossible for one person to embezzle funds. Collusion becomes necessary, lessening the chance for fraud. Internal controls must be costs effective and so this idea of separation of duties has limits. Separation of duties is a fairly straightforward proposition in large businesses but smaller business may not be able to cost effectively add a position solely to gain separation of duties.

Exhibit 1.2

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5417 Pinnacle Point Drive
Suite 501
Rogers, AR 72758

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders of Wal-Mart Stores, Inc.
702 S. W. 8th Street
Bentonville, Arkansas

We have audited the accompanying consolidated balance sheets of Wal-Mart Stores, Inc. as of January 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended January 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Wal-Mart Stores, Inc. at January 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2014, in conformity with U.S. generally accepted accounting principles.

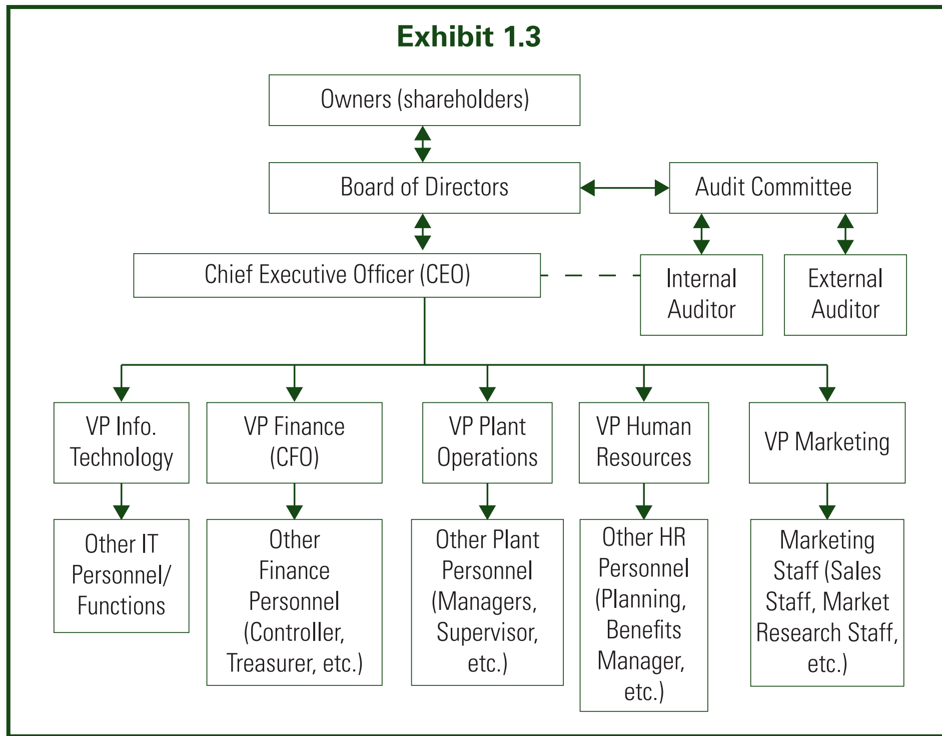
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Wal-Mart Stores, Inc.'s internal control over financial reporting as of January 31, 2014, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) and our report dated March 21, 2014 expressed an unqualified opinion thereon.

Ernst & Young, LLP
Rogers, Arkansas
March 21, 2014

- Numeric controls: One of the best examples of numeric controls is a pre-numbered document. With pre-numbered documents, the universe of test items is known. Everyone is familiar with the concept of pre-numbered checks. In business systems with strong internal control many items are pre-numbered for control purposes (checks, sales invoices, sales orders, purchase orders, purchase requisitions, receiving documents, etc.). Electronic numeric controls are now commonplace as well, such as batch and file totals.
- Crosschecks: Strong control systems have built in crosschecks that may be manual or electronic. A bank reconciliation that reconciles the balance according to the bank statement with the balance according to the books is a crosscheck. A systematized comparison of (1) a vendor's invoice for goods purchased, (2) a receiving report, and (3) a purchase order before a check is drawn payable to a vendor is another crosscheck.
- Internal audit function: An independent internal audit function within an organization may provide constant high-level monitoring of the operations of the entire internal control system.

Corporate governance is itself an important part of internal control. For example, a separate and independent audit committee should exist. A primary role of the audit committee should be the selection of the external auditor. The audit committee should limit the work done by the external auditor. In fact, SOX now places limits on the work that an auditor may do for a public client. (In the case of Enron, the audit firm, Arthur Andersen, performed considerable management advisory services in addition to audit service, which placed Andersen's independence in serious question.) The audit committee should create a charter for itself

specifying its oversight role. The charter may address the audit committee's role in numerous areas such as: a) appointing the external auditor, b) using special executive sessions, with or without management's presence, with any party that the audit committee deems appropriate (outside auditors, internal auditors, CEO, CFO, attorneys, consultants, etc.), and c) creating whistle-blower policy, to mention a few. As mentioned, a key control for larger organizations is an internal audit function, the director of which should report to a high level within the organization such as the board's audit committee primarily, with a dotted line to top management. Audit committees that report to lower levels of management have difficulty establishing sufficient objectivity in their reporting. (See Exhibit 1.3)



1.5c Education, Experience, and Ethics

Generally, to become a licensed CPA, 150 credit hours of collegiate education must be completed, experience requirements must be met, and a rigorous examination must be passed that covers general business and economic issues, information technology, finance, managerial accounting concepts, generally accepted accounting principles (GAAP), generally accepted auditing standards (GAAS), tax law, business law, and the AICPA's *Code of Professional Conduct* (ethics). Education provides a person with exposure to the vast common body of knowledge that is a part of both GAAP and GAAS and begins to present students with some of the ethical challenges they may face in practice. Experience provides practitioners with a higher level of competence and the ability to make sound and ethical judgments as they apply the common body of knowledge to real accounting, auditing, consulting, and taxation issues.

The AICPA's *Code of Professional Conduct* addresses the need for integrity, objectivity, independence, and the exercise of due care as professionals in relationships with colleagues, clients, and the general public. Other professional accounting organizations also have codes of ethics. For example, the Institute of Management Accountants (IMA) has a *Statement of Ethical Professional Practice* and the Institute of Internal Auditors has a *Code of Ethics*, and these documents stress the need for integrity, fairness, objectivity, competence, and confidentiality in professional practice.

1.6 Accounting Career Opportunities

Numerous career opportunities are available in the accounting profession in public accounting, managerial accounting, governmental accounting, and accounting education.

In public accounting, accountants perform audit, tax, and management advisory services. As described earlier, the audit role involves an independent examination of client company financial statements that results in a written opinion on the fairness of those financial statements. This is a valuable societal service. The public relies on sound financial information before investments are made often using audited financial statements and auditor's opinions as a basis for their final decisions. Public accountants prepare tax returns and perform tax planning for individuals and businesses. And public accountants perform management advisory services to clients in very diverse areas including systems advice, mergers and acquisitions, and forensic accounting, to mention a few.

In managerial (sometimes called private) accounting, accountants also perform an array of functions for a single business, including planning, budgeting, treasury functions, controllership (chief financial officer), and internal auditing.

In governmental accounting, accountants are also needed for both accounting and auditing roles. The Government Accountability Office (GAO) is often referred to as the investigative arm of Congress, performing audits of numerous federally sponsored programs, including federal agencies and private concerns, and reporting the audit results to Congress. The U.S. Internal Revenue Service (IRS) also performs audits of federal tax filings of individuals and businesses. Public companies are required to file financial statements with the U.S. Securities and Exchange Commission (SEC). SEC accountants examine these filings to determine if there are any deficiencies (lack of adherence to GAAP, inadequate disclosures, etc.) worthy of investigation or legal action. Many other governmental agencies, state and local governmental agencies as well as federal governmental agencies, need accountants to conduct day-to-day operations and auditors to perform audits related to both financial reporting and agency performance.

Accountants may also find rewarding careers in education. As educators, accountants engage in teaching, research, and service to their colleges or universities and to professional organizations.

No matter what the field of endeavor within the accounting profession, it is important for accounting majors to consider taking the uniform CPA examination early in their careers. As mentioned earlier, the CPA examination is rigorous, containing four parts over a 14-hour period that cover a wide range of business topics. The examination is given electronically in over 300 sites in the United States.

Many students who will read this book are not accounting majors. Nevertheless, knowledge of the accounting principles you will learn here is essential to your professional and personal life. Professionally, no matter what your field of endeavor, you can count on being inundated with financial information. It is important that you are able to interpret basic financial statements regardless of whether your field is fashion, engineering, architecture, medicine, or another business area such as marketing, management, or finance. And personally, you will be balancing checkbooks and making all sorts of investment decisions. The stronger your knowledge of the financial world in our complex economy, the better off you will be.

Chapter 1 Exercises

E1.1 Presently, although the Securities and Exchange Commission (SEC) is the only body in the United States that can make laws regarding rules for accounting and financial reporting, the SEC has traditionally deferred to the Financial Accounting Standards Board (FASB), which is the principle accounting rule-making body in the United States. Why is there a strong movement in the United States and internationally toward acceptance of the accounting standards promulgated by the International Accounting Standards Board (IASB)?

E1.2 Accounting and reporting standards are primarily rules-based if they are

a) IASB standards.
b) FASB standards.

E1.3 Accounting and reporting standards are primarily principles-based if they are

a) IASB standards.
b) FASB standards.

E1.4 Accounting and reporting standards that are principles-based present fewer legal issues than accounting and reporting standards that are rules-based.

a) True.
b) False.

E1.5 The integrity of financial statement presentations and disclosures is enhanced when

a) The financial statements are audited by a CPA.
b) The financial statements are prepared in an environment that includes a strong system of internal control.
c) The financial statement preparers have the appropriate education and experience necessary.
d) All of the above.

E1.6 An auditor rendered an opinion on a company's financial statements which stated that the statements were fair in all material respects taken as a whole except for the treatment of a lease in a manner that materially violated generally accepted accounting principles for lease accounting. The most likely type of opinion the auditor rendered on the financial statements was

a) An unmodified opinion.
b) A qualified opinion.
c) An adverse opinion.
d) A disclaimer of opinion.

E1.7 Internal control is a process that has as its objectives

a) The reasonable assurance of reliable financial reporting.
b) Compliance with laws.
c) Effective and efficient operations.
d) All of the above.

E1.8 The external auditor should report to

a) The CEO.
b) The CFO.
c) The audit committee.
d) All of the above.

E1.9 The Statement of Financial Position of Fashion Apparel Boutique, Inc. as of December 31, 20X9 included total assets of $86,000,000 and total stockholders' equity of $46,000,000. At December 31, 20X9, total liabilities were

a) $40,000,000.
b) $46,000,000.
c) $132,000,000.
d) Cannot be determined from information provided.

E1.10 Which of the following financial statements shows financial information as of a specific date and not for a period of time?

a) The statement of financial position (balance sheet).
b) The income statement.
c) The statement of cash flows.
d) All of the above.

E1.11 According to the FASB's conceptual framework for financial reporting, faithful representation refers to

a) the completeness of financial information.
b) the neutrality or unbiased nature of financial information.
c) the error free nature of financial information.
d) all of the above.

E1.12 According to the FASB's conceptual framework for financial reporting, predictive value of financial information relates to

	Relevance	Faithful Representation
a)	Yes	No
b)	Yes	Yes
c)	No	Yes
d)	No	No

E1.13 According to the FASB's conceptual framework for financial reporting, information represents what it purports to represent when it is

a) comparable.
b) timely.
c) verifiable.
d) understandable.

E1.14 According to the FASB's conceptual framework for financial reporting, which of the following items is not an enhancing qualitative characteristic?

a) verifiability.
b) faithful representation.
c) comparability.
d) timeliness.