Financial Reporting

Uniform Certified Public Accountant (CPA) Examination

30 to 40% of FAR · 47 representative tasks · AICPA CPA Exam Blueprints

Financial Reporting is about producing and fixing the statements themselves: the business set, the not-for-profit set, the government fund view, SEC filings, special purpose frameworks and the ratios built from them. Most tasks ask you to prepare a statement, correct an error or trace a figure back to its support, so practice the mechanics until classification and sign are automatic.

You should be able to: Check yourself: can you prepare each business statement from a trial balance, fix a misclassified cash flow, place a gift in the right net asset class, pick the right government fund and compute diluted EPS without notes?

Every topic: the key point and the trap

Business financial statements

A classified balance sheet splits assets and liabilities into current (due or used within 12 months or the operating cycle, if longer) and noncurrent; the current portion of long-term debt moves to current liabilities.

Trap: Adding the gain on a sale to operating cash, or reporting only the gain in investing: subtract the gain in operating activities and report the whole cash proceeds in investing activities.

Not-for-profit financial statements

Net assets fall into two classes: without donor restrictions and with donor restrictions (ASC 958-210). The statement of financial position reports totals for the entity as a whole and information about liquidity.

Trap: Recording the $45,000 program cost as an expense of the with donor restrictions class. The expense is always in the without class; the release is the bridge.

Government funds and bases

Government-wide statements use the economic resources measurement focus and full accrual basis; governmental funds use the current financial resources focus and modified accrual basis (GASB 34).

Trap: Recording the bond liability or the building in the capital projects fund. Governmental funds show bond proceeds as an other financing source and construction as an expenditure.

SEC filings and earnings per share

Form 10-K is the annual report with audited statements; Form 10-Q covers each of the first three fiscal quarters with reviewed interim statements; Form 8-K reports specified major events, generally within four business days.

Trap: Subtracting cumulative preferred dividends only when declared, or subtracting prior years' arrears. Take the current year's cumulative dividend every year, declared or not, and never the arrears.

Special purpose frameworks

Statements on a special purpose framework carry titles that avoid GAAP names: for the cash basis, a statement of assets and liabilities arising from cash transactions and a statement of revenues collected and expenses paid; for the tax basis, a statement of assets, liabilities and equity (income tax basis) and a statement of revenues and expenses (income tax basis).

Trap: Reversing the unearned revenue adjustment. A decrease in unearned revenue means more revenue was earned than collected, so it adds to revenue.

Ratios, metrics and budget variances

Profitability: gross margin = gross profit / net sales; return on sales = net income / net sales; return on assets = net income / average total assets; return on equity = net income / average equity.

Trap: Using sales instead of cost of goods sold for inventory turnover, or a year-end balance where the ratio calls for an average.

Key terms

Other comprehensive income: Gains and losses recognized in equity outside net income, later reclassified for some items.

Noncontrolling interest: The part of a subsidiary's equity not owned by the parent, shown within consolidated equity.

Discontinued operation: A disposed or held-for-sale component whose exit is a strategic shift with a major effect on results.

Operating cycle: The time from paying cash for inventory to collecting cash from customers.

Net assets with donor restrictions: Resources whose use is limited by a donor's purpose or time stipulation, including endowment.

Release from restriction: A reclassification from with to without donor restrictions when the stipulation is met.

Functional classification: Grouping expenses into program services and supporting activities.

Modified accrual: The governmental fund basis: revenues when measurable and available, expenditures when the liability is incurred.

Enterprise fund: A proprietary fund for activities financed mainly by fees charged to outside users.

Custodial fund: A fiduciary fund for resources held for others that are not in a trust.

Treasury stock method: Assumes option proceeds buy back shares at the average market price; only the net new shares count.

If-converted method: Assumes conversion at the start of the year, adding shares and removing the related dividends or after-tax interest.

Antidilutive: A security whose assumed conversion or exercise would increase EPS or reduce a loss per share.

Special purpose framework: A basis other than GAAP, such as cash, modified cash, tax or regulatory basis.

Modified cash basis: The cash basis with selected accrual changes that have substantial support in practice.

Income tax basis: Statements measured the way the entity measures items on its federal return.

Quick ratio: Liquid assets (cash, marketable securities, net receivables) over current liabilities; excludes inventory and prepaids.

EBITDA: Earnings before interest, taxes, depreciation and amortization; a non-GAAP measure.

Flexible budget: A budget recast at the actual level of activity.

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