Question #1 of 53

The actuarial present value of all future pension benefits earned to date, based on expected future salary increases, is called the:

A) projected benefit obligation (PBO).

B) pension liability.

C) total projected pension cost.

Question #2 of 53

Consider a situation at a firm where the differences in its cash flow and economic pension expense are considered material to the financial statements. The relevant tax rate is 30%. The expected return on plan assets is $120,000, interest cost is $85,000, employer's contribution is $215,000, service cost is $450,000, and the actual return on plan assets is $50,000. Based on the information provided and for analytical purposes only, which of the following statements is *most* appropriate?

A) There is a reclassification of $189,000 from operating cash flow to financing cash flow.

B) There is a reclassification of $140,000 from operating cash flow to financing cash flow.

C) There is a reclassification of $270,000 from operating cash flow to financing cash flow.

Question #3 of 53

Which of the following statements about stock appreciation rights, performance stock, and phantom stock is *most* accurate?

A) Performance stock cannot be sold by the employee until vesting has occurred.

B) Phantom stock payoffs are based on the performance of the firm's actual shares.

C) Stock appreciation rights never have any dilution effect on the existing shareholders.

Question #4 of 53

Which of the following statements regarding pension accounting is *most* accurate?

A) A reconciliation between the funded status and the net pension asset (liability) reported on the balance is required.

B) Changes in the projected benefit obligation (PBO) and plan assets fully and immediately affect the balance sheet.

C) Changes in actuarial assumptions and past service costs fully and immediately affect the income statement.

Question #5 of 53

Under current U.S. GAAP, the assets and liabilities of a defined benefit pension plan are:

A) off balance sheet items which are shown only in the footnotes.

B) netted against each other, and only the net asset or liability amount is reported on the company's balance sheet.

C) reported in the appropriate section of the balance sheet, with pension obligations shown under liabilities and plan assets shown under assets.

Question #6 of 53

Which of the following statements regarding the projected benefit obligation (PBO) and the value of the pension plan assets is *most* accurate?

A) If the PBO and the plan assets are the same, then nothing needs to be reported on the balance sheet.

B) The fair value of plan assets is increased by the amount of the expected return on assets.

C) Plan amendments during the year generally result in a decrease of the PBO at the end of the year.

Question #7 of 53

Which of the following is NOT an advantage of share based compensation over cash compensation?

A) Share based compensation does not require a cash outlay.

B) Share based compensation serves to align employee interest with the interests of stockholders.

C) In a share based compensation plan, expense is not recognized, unless the exercise price is set below the market price.

Question #8 of 53

The following information relates to Nazarali Inc. (Nazarali) and its defined-benefit pension plan for the year:

Contributions	\$3.0 million
Reported pension expense	\$2.8 million
Total periodic pension cost	\$3.1 million

Based on the information above, which of the following statements is *most* accurate?

A) There is a source of borrowing of \$100,000.

B) There is a reduction in the overall pension obligation of \$200,000.

C) There is a reduction in the overall pension obligation of \$100,000.

Jason Moore, CFA, is a credit analyst for Everest Bank in New York in the firm's investment banking division. An existing customer of Everest, Longhorn Partners, which is based in Texas, has approached the bank for a \$45 million loan to be used to acquire a smaller competitor. Moore has been appointed head of the credit team that will review Longhorn's current business with Everest as well as Longhorn's current operations, in order to assess Longhorn's request.

Overall, Longhorn has achieved consistent profitability over the last decade. The company is appropriately leveraged and appears to be well-run by its senior management team. However, there are a couple of items in the company's financial statements that Moore believes may warrant further analysis. He specifically wants to adjust Longhorn's reported operating profit for comparative analysis with other companies who may not report their entire pension expense as an operating expense.

For many years, Longhorn has offered to its fulltime employees a traditional defined-benefit pension plan: eligible employees are promised an annual pension payment of 3% per year of service times their annual salary at retirement. Selected information regarding the pension plan from Longhorn's most recent financial statement is as follows:

Pension Benefit Obligation (PBO) (ending)	$85,475,000
Accumulated Benefit Obligation (ABO) (ending)	65,250,000
Fair value of plan assets (ending)	71,365,000
Fair value of plan assets (beginning)	66,360,000
Operating income	17,185,000
Interest expense	1,285,000
Pension Expense	5,456,000
Contributions	7,200,000
Service cost	4,114,000
Interest cost	5,342,000
Discount rate	6.25%

Additionally, Longhorn has a share-based compensation plan for its senior executives.

Question #9 of 53

The balance sheet asset/liability related to Longhorn's pension plan is *closest* to:

A) a liability of $6,115,000.

B) a liability of $14,110,000.

C) an asset of $6,115,000.

Question #10 of 53

Moore reads in the footnotes to Longhorn's financial statements that the pension plan's PBO increased by $5,000,000 last year. Of this amount, approximately 50% was attributed to benefits earned by its employees that year. The remaining 50% was attributed to a change in the pension plan's actuarial assumptions. Which of the following changes to actuarial assumptions is *most likely* to cause an increase in PBO? A decrease in the:

A) discount rate.

B) expected rate of return.

C) rate of compensation growth.

Question #11 of 53

Compared to the reported net income, if Longhorn had used a higher stock price volatility assumption in valuing stock option grants to its senior executives, Longhorn's net income would have *most likely* have been:

A) unchanged.

B) higher.

C) lower.

Question #12 of 53

Compared to the reported compensation expense, if Longhorn had used a lower estimated life assumption in valuing stock option grants to its senior executives, Longhorn's compensation expense would have *most likely* been:

A) lower.

B) unchanged.

C) higher.

Question #13 of 53

Longhorn's adjusted operating profit is *closest* to:

A) $15,843,000

B) $18,527,000

C) $14,110,000

Question #14 of 53

Assume for this question only that the actual return on plan assets was $981,200 higher than the expected return of $5,308,800. The amount of benefits paid to plan participants was *closest* to:

A) $1,285,000.

B) $8,485,000.

C) $5,192,000.

Question #15 of 53

Which of the following statements regarding pension accounting under U.S. GAAP standards and/or under International Financial Reporting Standards (IFRS) is *most* accurate?

A) Under IFRS and U.S. GAAP, the calculation of pension expense is the same.

B) Under IFRS, the funded status (difference in the PBO and the plan assets) is reported on the balance sheet.

C) Under U.S. GAAP, firms are required to provide a reconciliation of the funded status and the reported net pension asset or liability.

Question #16 of 53

Financial analysts can use select data from a company's financial statements to derive total periodic pension cost in order to better reflect the company's true economic pension cost. Which of the following formulas will *most* accurately calculate a company's true pension expense?

A) Service cost + interest cost + plan amendments – actual return on plan assets.

B) Service cost + interest cost – actual return on plan assets – benefits paid.

C) Beginning fair value of plan assets + service cost + interest cost – ending fair value of plan assets.

Question #17 of 53

The projected benefit obligation (PBO) is defined as the:

A) actuarial present value of all future pension benefits earned to date and based on current salary levels.

B) actuarial present value of all future pension benefits earned to date based on expected future salary increases.

C) actuarial future value of all post-retirement healthcare benefits earned to date.

Question #18 of 53

Roberto Perez, CFA, is the Chief Financial Officer for Home Stores, Inc., a large home improvement retailer with stores located across the United States. Home Stores is preparing for a secondary stock offering to secure the necessary capital to pursue an aggressive expansion campaign. Perez has received a directive from his boss to make every legitimate effort to present Home Stores' upcoming financial statements in the best possible light. Perez determines that certain assumptions in the pension plan can be changed to fulfill this request. Which of the following pension plan assumptions can be changed by a firm to manipulate its reported results?

Change	Result

A) decreased discount rate | increased expected return

B) decreased rate of compensation | decreased service cost

C) increased expected rate of | decreased service cost

Question #19 of 53

In determining the fair value of employee stock options, which of the following statements is *most* appropriate?

A) Absent a market-based instrument, U.S. GAAP and IFRS prefer firms to use the Black-Scholes option-pricing model.

B) A lower risk-free rate will usually increase the estimated fair value.

C) A higher than expected dividend yield will decrease the estimated fair value.

Question #20 of 53

Federal Companies reported the following information in the footnotes to its most recent financial statements:

Beginning Projected Benefit Obligation (PBO)	$65,000,000
Ending PBO	90,000,000
Service Cost	27,000,000
Interest Cost	3,000,000
Benefits Paid	5,000,000
Actual Return on Plan Assets	7,500,000
Expected Return on Plan Assets	8,500,000

Given the information above, calculate Federal's total periodic pension cost for the year.

A) $41,000,000.00

B) $27,500,000.00

C) $22,500,000.00

Question #21 of 53

A company reporting under U.S. GAAP reduced the discount rate for its pension obligation from 10% to 8%, reduced the expected long-term rate of return on the assets in its pension plan from 8% to 6%, and changed its compensation growth rate assumption from 4% to 5%. What is the *most likely* impact of these changes on the current year ending defined benefit obligation and pension expense?

A) The decrease in the long-term rate of return on plan assets will decrease reported pension expense.

B) The decrease in the long-term rate of return will have no impact on the defined benefit obligation and will increase reported pension expense.

C) The reduction in the discount rate will decrease the defined benefit obligation and will increase reported pension expense.

Question #22 of 53

Fly-By-Night Airlines is a U.S. company planning to change its pension plan so that it can reduce its costs. It is considering reducing its defined benefit percentage from 10% to 5% of ending salary, retroactive for 10 years. In addition, since the firm is anticipating substantially reduced salary increases in the future, it is planning to reduce its compensation growth rate assumption. From a pension accounting perspective, the change in the:

A) Compensation growth rate assumption is a change in actuarial assumption that will reduce the defined benefit obligation and future pension expense.

B) Benefit percentage is a change in actuarial assumption that will be recognized in full in current period pension expense.

C) Benefit percentage is a past service cost that will be amortized into and thus increase pension expense over the remaining service lives of its employees.

Question #23 of 53

Which of the following measures is *least* sensitive to changes in pension plan actuarial assumptions?

A) Balance sheet asset or liability.

B) Total periodic pension cost.

C) Projected benefit obligation (PBO).

Question #24 of 53

Which of the following statements about the methods of valuing employee stock options is *least* accurate?

A) With the intrinsic value method, once the options are in-the-money, compensation expense is recognized on the income statement.

B) With the fair value method, compensation expense is allocated in the income statement for the period between the grant date and the vesting date.

C) With either method, the offset to compensation expense recognized is an increase in paid-in capital.

Question #25 of 53

Tim Gresham, CFO of Alpha Logistics is concerned about changes in the business environment which could lead to Alpha violating some of the covenants of their outstanding debentures. Specifically Gresham is concerned about leverage and profitability ratios. Gresham reviews Alpha's most recent financial statements and decides that changing the assumptions for the company's defined benefit pension plan may provide some relief in the short-run. Alpha reports under U.S. GAAP.

Which of the following changes in the pension plan's assumptions would *most likely* lead to lower reported leverage and higher reported profitability?

A) Increasing the discount rate.

B) Increasing the growth rate in compensation expense.

C) Increasing expected return on plan assets.

Question #26 of 53

Peak Productions is a publicly traded company that manufactures consumer electronics products in the U.S. The company has been in operation nearly fifty years, and has a considerable pension plan liability on its financial statements. Peak has a well-deserved reputation among analysts of utilizing aggressive accounting practices with regard to its pension plan. Which of the treatments of the following actuarial assumptions is the *best* example of aggressive accounting for a pension plan?

A) A high discount rate.

B) A high calculated projected benefit obligation (PBO).

C) A high compensation growth rate.

Question #27 of 53

Wonderful Manufacturing has implemented a change in its pension plan, that will increase the future benefits for all of its current employees. Which of the following is the *most likely* effect on the company's financial statements of this change in promised benefits under current U.S. GAAP standards?

A) The pension expense for the next reporting period will increase by the projected increase in pension benefits due to employees.

B) The net pension liability will increase immediately by the projected increase in pension benefits due to employees.

C) The firm's prior financial statements will be adjusted to reflect the increase in benefits.

Question #28 of 53

The financial statements of Pace Industries issued over the past five years show a progressively increasing net difference between the value of its pension fund and the projected future pension liability on the balance sheet. Pace *most likely* offers which of the following types of pension plans to its employees?

A) A defined contribution plan.

B) A 401(k) plan.

C) A defined benefit plan.

Question #29 of 53

When considering the major differences between a defined contribution and a defined benefit pension plan, which of the following statements is *most* accurate?

A) Accounting for a defined contribution pension plan is the most complicated because of the many investment options available to the employees.

B) A company with a defined contribution plan will report on its balance sheet the net difference between the value of the pension fund assets and the value of the pension

C) Among the different types of pension plans, accounting for a pay-related defined benefit plan is the most complicated because of the required actuarial assumptions.

Question #30 of 53

Wes Livingston is the founder and CEO of Bigwell Corporation. Livingston is interested in Bigwell being acquired by a larger competitor and wants to have his company's financial statements appear as attractive as possible to a potential suitor. In order to decrease the projected benefit obligation (PBO) of the company's pension plan, which of the following changes in actuarial assumptions could be made?

A) Increase the discount rate.

B) Decrease the discount rate.

C) Increase the rate of compensation growth.

Question #31 of 53

The Board of Directors of Prime Bank has asked management to make changes in the accounting of its pension plan obligations in order to decrease the reported service cost. Management determines that there are two changes in actuarial assumptions that will result in a lower service cost. Which of the following pairs of changes in actuarial assumptions will *best* achieve the desired effect? Prime Bank can either:

A) decrease the rate of compensation growth or increase the expected rate of return.

B) decrease the discount rate or increase the expected rate of return.

C) increase the discount rate or decrease the rate of compensation growth.

Paul Roberts, CPA, is a partner in Roberts & Smith, an accounting firm that is located in Chicago. The firm has recently been retained by Midwest Manufacturing, a major producer of heavy machinery and tractor parts in the U.S. Midwest has been in operation since 1965, and currently has approximately 700 full-time employees. The company had its initial public offering in 1986. The company has hired Roberts's firm to ensure that the accounting for Midwest's employee pension plan is fully in compliance U.S. GAAP standards.

Selected year-end pension plan information for Midwest Manufacturing

	2006	2007
PBO	$21 million	$23 million
Discount Rate	6.0%	7.5%
Rate of Compensation Increase	4.0%	4.0%
Benefits paid	$0.8m	$1m
Interest cost		$1.6m
Service cost		$3m

Roberts will educate Midwest's accounting department on pension plan accounting that would be relevant to their situation.

Question #32 of 53

In accordance with U.S. GAAP, distinguish which of the following events are classified as "actual" events and which ones are "smoothed" events.

	Actual	Smoothed
A)	interest cost	total periodic pension cost
B)	service cost	interest cost
C)	service cost	expected return on plan assets

Question #33 of 53

Based on the information provided, the impact of change in discount rate in 2007 (as compared to 2006) is *closest* to:

A) a decrease in PBO of $2.6 million.

B) a decrease in PBO of $1.6 million.

C) a decrease in PBO of $2 million.

Question #34 of 53

As of January 1st, 2007, the fair value of plan assets was $19 million. Which three components are necessary to calculate the fair value of the plan assets at the end of the year?

A) service cost, interest cost, and benefits paid.

B) actual return on assets, employer contributions, and benefits paid.

C) expected return on plan assets, employer and participant contributions, and benefits paid.

Question #35 of 53

Current U.S. GAAP pension accounting standards require public companies to report which of the following in the balance sheet?

A) The funded status of the plan.

B) The pension liability adjusted for unrecognized items.

C) The expected return on plan assets.

Question #36 of 53

As of December 31st, 2007, the fair value of plan assets was $21 million. For this question only, assume that the sum of the unrecognized prior service cost and the unrecognized actuarial losses equals $1.5 million. Calculate the amount attributable to Midwest's pension plan as of December 31st, 2007 that must be reported on the balance sheet under U.S. GAAP.

A) $2.0 million.

B) −$2.0 million.

C) −$500,000.

Question #37 of 53

Which of the following statements regarding the U.S. GAAP pension accounting standards is *most* accurate?

A) For most companies, the pension liability will increase while financial leverage may increase or decrease as a result of applying the standard.

B) The changes in GAAP now cause U.S. standards to be consistent with the International Financial Reporting Standards (IFRS) for pension plans.

C) The balance sheet will now reflect the true economic position of the pension plan, but the income statement will not necessarily reflect a true measure of economic pension

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Question #38 of 53

An analyst views the assumptions made by a company reporting under U.S. GAAP regarding its pension liabilities as unrealistic, and thinks the discount rate and expected rate of return should both be increased. The *most likely* effect of increasing the discount rate and expected rate of return on the pension benefit obligation (PBO) is:

	Discount rate	Expected rate of return
A)	Decrease	No effect
B)	Increase	Decrease
C)	No effect	Decrease

Jon Horton, CFA, is the Chief Financial Officer (CFO) for Springtown Corporation, a manufacturer of windows for residential and commercial applications. As part of an ongoing diversification strategy, Springtown Corp. has recently entered into a preliminary agreement to purchase all of the assets of Prime Doors, a manufacturer and distributor of doors to the same residential and commercial market in which Springtown sells its windows. Horton is head of the due diligence team that will fully evaluate Prime Doors' financial statements prior to the proposed acquisition.

Prime Doors has been in operation for thirty years, and currently has approximately 800 employees at two operating facilities. Horton observes in the notes to the financial statements that Prime Doors has a defined benefit pension plan, for which all employees are eligible. Employees are vested at the rate of 20% per year of employment, and are fully vested upon completion of five years of employment. Springtown does not offer a pension plan to its employees, but encourages employees to contribute to Individual Retirement Accounts (IRAs) and offers a 401(k) program.

Horton wants to fully evaluate the financial implications of Springtown's assumption of Prime Doors' pension assets and the associated future liabilities and expenses. Like most companies, the pension plan for Prime Doors' employees is not fully funded, but Horton wants to review all assumptions used by Prime Doors' accountants in the valuation of the plan's current liabilities. The most current information regarding the pension plans is as follows:

Select Pension Plan Information for Prime Doors (as of 12/31/05)	
Projected benefit obligation (PBO)	$15,500,000
Accumulated benefit obligation (ABO)	$13,750,000
Market value of plan assets	$11,875,000

Horton notices a paragraph in the pension plan footnotes that the original pension plan was amended last year, effectively increasing the level of benefits to be paid to employees with more than ten years of service. However, he is not able to detect what effect, if any, this change in projected benefits has had on Prime Doors' financial statements or is expected to have in the future.

Horton is aware that a commonly used method can be used to adjust the income statement and provide a better measure of Prime Doors' economic pension cost than reported pension expense. He is not quite sure which components of the financial statements are utilized to derive an adjusted pension expense, but intends to investigate what analysis he can perform to gain more insight into the company's position with regards to its pension plan.

Question #39 of 53

When accounting for pension liabilities in the U.S., a company must make fundamental assumptions to estimate the future liability and expense for each employee. How are the following assumptions required to be treated in the pension footnotes?

	Required disclosure	Not required to be disclosed
A)	Rate of compensation	Expected length of
B)	Discount rate	Expected return on
C)	Discount rate	Rate of compensation

Question #40 of 53

What effect will an increased discount rate and increased expected rate of return have on a company's projected benefit obligation (PBO) and accumulated benefit obligation (ABO) as reflected in the financial statements?

A) Only one will increase.

B) Both will increase.

C) Both will decrease.

Question #41 of 53

According to U.S. GAAP, companies must account for pension assets and the associated pension obligation in their financial statements. These could be reported in two ways. Method 1 is to report the values of the pension fund assets and liability separately on the balance sheet. Method 2 is to report a net amount for the difference between the value of the fund assets and the fund liabilities. Which of the following statements *most* accurately describes the requirements of U.S. GAAP?

A) Companies are required to use Method 2.

B) Companies may choose to use either method.

C) Companies are required to use Method 1.

Question #42 of 53

Prime Doors has recorded a net pension liability of $1.5 million on its balance sheet. According to current U.S. accounting standards, Prime Doors is required to:

A) immediately recognize $2,125,000 as additional pension expense in its income statement.

B) record $2,125,000 as additional pension liability on its balance sheet.

C) record $375,000 as additional pension expense on its balance sheet.

Question #43 of 53

Which of the following statements regarding the treatment of pension plan amendments under U.S. GAAP standards is *most* accurate? A plan amendment results in:

A) the disclosure in the pension plan footnotes of the nature of the amendment and the projected future financial impact.

B) an unrecognized prior service cost that is amortized over the expected remaining service life of the affected employees.

C) an immediate increase in pension expense equal to the amount of the amendment.

Question #44 of 53

Pension expense as reported by a firm is routinely adjusted by analysts to derive a more accurate measure of a firm's true economic pension cost. Economic pension expense is calculated as:

A) reported pension expense – service cost + interest cost.

B) Contribution – (Ending funded status – beginning funded status)

C) reported pension cost – actual return on plan assets.

Jason Johnson, CFA, is a principal of a large private equity firm in New York. One of the associates in his firm has identified a potential investment opportunity for the firm: Gasline, Inc. is a major producer of carbon steel pipe used in the transportation of natural gas in the Southwestern United States.

Of particular concern to Johnson is Gasline's numerous, complicated transactions related to the company's various stock-based compensation plans and its defined benefit pension plan.

For example, the CEO of Gasline was awarded a stock option package at the beginning of 2013, which could ultimately have a significant impact on the company's future earnings. Details of the CEO's stock option grant are outlined below:

CEO Options (grant date January 1, 2013)

Strike price	$37.00
Current market price	$35.00
Number of options	100,000
Option period	4 years
Vesting period	25% per year

Question #45 of 53

For the valuation of the CEO's stock options granted on January 1, 2013, Gasline estimated a fair value of $100,000 by using Monte Carlo simulation.

In accordance with SFAS No. 123(R), which of the following statements is *most* accurate? Gasline's accounting treatment of the options is:

A) in compliance because a Monte Carlo simulation is an acceptable method of valuing options in the absence of a market-based instrument.

B) in compliance because the firm can elect to use either the intrinsic value model or the fair value model in the valuation of stock option plans.

C) not in compliance because the fair value must be established by using the Black-Scholes option pricing model.

Question #46 of 53

Assume that the CEO of Gasline exercises $25,000 of his options on December 31, 2013, and the market price of the stock on that date is $39.50. Calculate the total compensation expense for the year ending 2013 that Gasline should recognize in association with the CEO option grant.

A) $62,500.

B) $25,000.

C) $100,000.

Question #47 of 53

Which of the following actions by the management is *least likely* to reduce the reported option expense?

A) Assuming a lower stock price volatility.

B) Assuming a lower risk-free rate.

C) Assuming a low dividend yield on the stock

Question #48 of 53

If management increases the assumed discount rate, the *least likely* effect is that the:

A) pension expense reported in P&L will decrease.

B) plan assets will increase.

C) funded status will improve.

Question #49 of 53

Regarding Gasline's defined benefit pension plan: if management increases the expected return on plan assets, the *most likely* effect is that the:

A) pension expense reported in P&L would decrease.

B) funded status would improve.

C) total periodic pension cost would decrease.

Question #50 of 53

For this question only, assume that Gasline reports under IFRS. If changes in actuarial assumptions affecting the PBO lead to an actuarial gain, the *most likely* effect is that the:

A) total periodic pension cost would decrease.

B) plan assets would increase.

C) pension expense reported in P&L would decrease.

Question #51 of 53

Which of the following statements regarding total periodic pension cost is *least* accurate?

A) It is equal to the sum of all the changes in projected benefit obligation (PBO) for the period (except for benefits paid) minus the actual return on assets.

B) It is a more volatile measure of pension expense than reported pension expense.

C) It is equal to the change in the funded status for the period.

Question #52 of 53

Which of the following statements about stock-based compensation are correct or incorrect?

Statement #1:	The grant date of a service-based award is the date when the employees' benefits are fully vested.
Statement #2:	When two or more performance conditions must be satisfied, the requisite service period ends when the first condition is met.

A) Both are correct.

B) Both are incorrect.

C) Only one is correct.

Question #53 of 53

In order to *decrease* the projected benefit obligation (PBO) of a pension plan, which of the following changes in pension assumptions can be made to yield the desired result?

A) Increase the expected rate of return.

B) Decrease the rate of compensation growth.

C) Decrease the discount rate.