

# FINANCIAL STATEMENT ANALYSIS PRACTICE TEST (SAMPLE)

STUDY GUIDE



**SAMPLE STUDY GUIDE  
WITH LIMITED QUESTIONS**

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<https://financialstatementanalysis.examzify.com>



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# Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- Practice answering questions under realistic conditions,
- Improve accuracy and speed,
- Review explanations to strengthen weak areas, and
- Approach the exam with greater confidence.

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

# How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here's how to get the most out of your Examzify study guide:

## 1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Your goal is to identify knowledge gaps early.

## 2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 – 45 minutes). Review a handful of questions, reflect on the explanations.

## 3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

## 4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

## 5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

## 6. Repeat and Review

Don't just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning. Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There's no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly, adapt the tips above to fit your pace and learning style. You've got this!

## Questions

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- 1. What does a high debt ratio indicate about financial risk?**
  - A. Lower Financial Risk
  - B. Improved Assets
  - C. Higher Financial Risk
  - D. Stable Profits
- 2. What is the accounting equation represented in the balance sheet?**
  - A. Revenue - Expenses = Net Income
  - B. Assets + Equity = Liabilities
  - C. Assets = Liabilities + Equity
  - D. Cash = Liabilities - Assets
- 3. What is the primary function of accumulated depreciation in financial reporting?**
  - A. To reflect the usage of an asset over time
  - B. To calculate net income
  - C. To manage cash flows
  - D. To assess market value
- 4. What relates to a company's main business of selling products or services to earn net income?**
  - A. Investing Activities
  - B. Operating Activities
  - C. Financing Activities
  - D. Cost of Goods Sold
- 5. What is the ending balance of retained earnings calculated as?**
  - A. Beginning Retained Earnings + Net Income
  - B. Retained Earnings + Net Income - Dividends
  - C. Net Income - Dividends
  - D. Beginning Retained Earnings - Dividends

- 6. Which of the following is an indicator of a company's operational efficiency?**
- A. Debt to Equity Ratio
  - B. Asset Turnover Ratio
  - C. Return on Assets
  - D. Current Ratio
- 7. What does liquidity in financial terms refer to?**
- A. The amount of assets owned by an individual
  - B. The ease with which an asset can be converted into cash
  - C. The overall profitability of a company
  - D. The total revenue generated from sales
- 8. What is the significance of the price to earnings (P/E) ratio?**
- A. It shows the total assets of a company
  - B. It indicates how much investors are willing to pay for each dollar of earnings
  - C. It reflects the company's total liabilities
  - D. It measures the company's equity
- 9. How is Return on Equity calculated?**
- A. Net Income/Total Assets
  - B. Net Income/Stockholders Equity
  - C. Net Income/Total Shares
  - D. Net Income/Debt Equity Ratio
- 10. What type of assets are characterized as having liquid value and being easily convertible into cash?**
- A. Current assets
  - B. Liquid assets
  - C. Fixed assets
  - D. Non-liquid assets



## **Answers**

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1. C
2. C
3. A
4. B
5. B
6. B
7. B
8. B
9. B
10. A

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## **Explanations**

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## 1. What does a high debt ratio indicate about financial risk?

- A. Lower Financial Risk
- B. Improved Assets
- C. Higher Financial Risk**
- D. Stable Profits

A high debt ratio indicates higher financial risk because it reflects a greater proportion of a company's assets being financed through debt rather than equity. When a company relies heavily on debt to fund its operations and growth, it becomes more vulnerable to fluctuations in earnings and broader economic conditions. This increased leverage can lead to amplified risks during downturns, as fixed-interest obligations must still be met regardless of a company's revenue performance. In essence, a high debt ratio suggests that a significant portion of the firm's financing comes with obligations that must be repaid, which can strain cash flow and limit financial flexibility. Consequently, if earnings decline or unexpected expenses arise, a highly leveraged company may struggle more than its less leveraged counterparts, increasing the overall financial risk associated with its operations.

## 2. What is the accounting equation represented in the balance sheet?

- A. Revenue - Expenses = Net Income
- B. Assets + Equity = Liabilities
- C. Assets = Liabilities + Equity**
- D. Cash = Liabilities - Assets

The accounting equation represented in the balance sheet is  $\text{Assets} = \text{Liabilities} + \text{Equity}$ . This fundamental equation illustrates the relationship between a company's resources and how those resources are financed. In essence, it shows that all the assets a company owns (what it is worth) are financed either by borrowing money (liabilities) or by using the owners' funds (equity). This equation must always balance, meaning the total value of a company's assets must equal the total value of its liabilities and equity at any given time, which is the crux of double-entry bookkeeping. The principle ensures that every financial transaction affects at least two accounts, maintaining the balance in the equation. Understanding this relationship is crucial for analyzing a company's financial health, as it provides insights into how well the business is managing its obligations and capital structure. The other options do not correctly reflect the core relationship defined by the balance sheet and do not fulfill the fundamental understanding required for financial statement analysis.

## 3. What is the primary function of accumulated depreciation in financial reporting?

- A. To reflect the usage of an asset over time**
- B. To calculate net income
- C. To manage cash flows
- D. To assess market value

Accumulated depreciation serves a critical role in financial reporting by reflecting the usage of an asset over time. This accounting practice allocates the cost of a tangible asset, such as machinery or buildings, across its useful life. As the asset is used, it depreciates in value, and this depreciation is recorded in the financial statements to indicate the portion of the asset that has been "used up" or expensed. By reporting accumulated depreciation, businesses provide stakeholders with insights into the wear and tear of their assets and how much of the original value remains on the balance sheet. It helps in understanding the financial position of a company by ensuring that assets are not overstated, thus providing a more accurate reflection of the company's net worth and operational efficiency. This function is essential for financial analysis, as it affects the income statement through depreciation expense and also influences asset valuation on the balance sheet. It allows analysts to better understand the efficiency and management of company resources over time.

**4. What relates to a company's main business of selling products or services to earn net income?**

- A. Investing Activities
- B. Operating Activities**
- C. Financing Activities
- D. Cost of Goods Sold

*The correct answer focuses on operating activities, which are directly linked to a company's core functions of generating revenue through the sale of products or services. These activities encompass the primary operations of a business, including sales revenue, cost of goods sold, and all expenses associated with production and delivery. Operating activities are critical in assessing a company's ability to generate cash flow from its typical business operations, which directly contributes to net income. This aspect is central to understanding a company's financial health and sustainability over the long term. While investing and financing activities are important components of overall financial analysis, they relate to different aspects of a company's financial management. Investing activities involve the acquisition and disposal of long-term assets, and financing activities pertain to how a company raises capital and manages its debts. Cost of goods sold captures the direct costs attributable to the production of goods sold, but does not encompass the entire scope of operating activities, which include all revenues and expenses generated from regular business operations.*

**5. What is the ending balance of retained earnings calculated as?**

- A. Beginning Retained Earnings + Net Income
- B. Retained Earnings + Net Income - Dividends**
- C. Net Income - Dividends
- D. Beginning Retained Earnings - Dividends

*The ending balance of retained earnings is calculated by taking the beginning retained earnings, adding the net income earned during the period, and then subtracting any dividends that have been paid out. This method reflects how profits are either retained in the business for growth or distributed to shareholders. Beginning retained earnings represent the balance at the start of the accounting period. By adding net income, you account for the earnings generated during that period, which increases the amount of retained earnings. Subtracting dividends is necessary because dividends represent a distribution of profits to shareholders, thus reducing the amount of earnings retained in the company for future use. This comprehensive formula captures the total impact of both profitability and the decisions made regarding profit distribution, leading to an accurate ending balance of retained earnings at the end of the accounting period.*

**6. Which of the following is an indicator of a company's operational efficiency?**

- A. Debt to Equity Ratio
- B. Asset Turnover Ratio**
- C. Return on Assets
- D. Current Ratio

*The Asset Turnover Ratio is indeed a strong indicator of a company's operational efficiency. This financial metric measures how effectively a company utilizes its assets to generate sales revenue. It is calculated by dividing the company's total sales or revenues by its average total assets. A higher Asset Turnover Ratio signifies that the company is efficiently managing its assets to produce revenue; in essence, it shows how well the company uses its asset base to maximize sales. Operational efficiency is fundamentally about how well a company converts its resources into income, and the Asset Turnover Ratio directly showcases this capability. In contrast, other options such as the Debt to Equity Ratio focus more on a company's capital structure and financial leverage, Return on Assets assesses the overall profitability relative to total assets without strictly indicating operational efficiency, and the Current Ratio pertains to liquidity and short-term financial health rather than operational efficiency. Hence, the Asset Turnover Ratio is the most relevant measure for evaluating how well a company operates.*

**7. What does liquidity in financial terms refer to?**

- A. The amount of assets owned by an individual
- B. The ease with which an asset can be converted into cash**
- C. The overall profitability of a company
- D. The total revenue generated from sales

*Liquidity in financial terms refers to the ease with which an asset can be converted into cash. This concept is crucial because cash is the most liquid asset, and the ability to quickly access cash can be vital for an individual or a business to meet its short-term obligations and operational needs. Assets, such as stocks, bonds, or real estate, vary significantly in their liquidity. For example, while cash and cash equivalents are considered highly liquid, real estate is generally less liquid because selling property can take time and involve significant transaction costs. Understanding liquidity helps analysts assess the financial health of a company and how easily it can face immediate liabilities. In contrast, the amount of assets owned or the total revenue generated does not directly relate to liquidity, as they can include both liquid and illiquid assets or factors that do not reflect the speed of converting assets to cash. Overall profitability pertains to the income statement rather than immediate cash availability, which is central to liquidity discussions.*

## 8. What is the significance of the price to earnings (P/E) ratio?

- A. It shows the total assets of a company
- B. It indicates how much investors are willing to pay for each dollar of earnings**
- C. It reflects the company's total liabilities
- D. It measures the company's equity

The price to earnings (P/E) ratio is a critical tool in financial analysis, particularly when evaluating the valuation of a company's stock. The ratio is calculated by dividing the market price per share by the earnings per share (EPS). It provides insight into how much investors are willing to pay for each dollar of earnings generated by the company. This willingness to pay is influenced by various factors, including growth prospects, the overall economic environment, and company performance. A high P/E ratio may suggest that investors expect future growth and are willing to pay a premium for the stock, while a lower P/E may indicate that the market has less confidence in the company's future performance. Understanding the P/E ratio allows investors to gauge whether a stock is overvalued, undervalued, or fairly valued in comparison to earnings. This determination guides investment decisions, helping investors assess potential risks and returns associated with purchasing shares of the company. The other options do not accurately reflect the purpose of the P/E ratio. It does not measure total assets, total liabilities, or equity, but rather focuses specifically on how much investors are investing relative to the company's earnings.

## 9. How is Return on Equity calculated?

- A. Net Income/Total Assets
- B. Net Income/Stockholders Equity**
- C. Net Income/Total Shares
- D. Net Income/Debt Equity Ratio

Return on Equity (ROE) is calculated by dividing net income by stockholders' equity. This formula measures how efficiently a company uses shareholders' funds to generate profits. By focusing on net income, which reflects a company's profitability, in relation to the equity invested by shareholders, it provides insight into how well the company is performing in terms of return on investments made by its owners. The use of stockholders' equity in the denominator is crucial because it signifies the portion of the company's assets that is financed by its owners. This metric allows investors to assess the effectiveness of management in utilizing equity financing to generate earnings, making ROE a vital indicator of financial performance. The other options are not appropriate calculations for ROE. For example, using total assets would not reflect the capital structure specific to shareholders' equity, and measuring against total shares doesn't account for profitability relative to equity financing. Lastly, incorporating the debt equity ratio into the denominator does not align with the standard calculation for ROE, as it mixes different financial metrics without accurately showing returns specific to equity holders.

**10. What type of assets are characterized as having liquid value and being easily convertible into cash?**

**A. Current assets**

B. Liquid assets

C. Fixed assets

D. Non-liquid assets

*Current assets are indeed characterized by their liquid value and their ability to be easily converted into cash. These assets typically include items such as cash and cash equivalents, accounts receivable, and inventory that can be sold or utilized within one operating cycle or within one year. Their liquidity is essential for day-to-day operations and for meeting short-term obligations. This concept is critical in financial analysis, as current assets show the short-term financial health of a company and its ability to cover immediate liabilities. The assessment of these assets helps stakeholders gauge how quickly a company can generate cash flow when needed, which is fundamental for operational effectiveness and financial management. While liquid assets also represent cash or assets that can quickly be turned into cash, current assets encompass a broader range of items that are classified based on their function in a business's operating cycle, making current assets the more comprehensive and suitable choice in this context.*

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## Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at [hello@examzify.com](mailto:hello@examzify.com).

Or visit your dedicated course page for more study tools and resources:

<https://financialstatementanalysis.examzify.com>

We wish you the very best on your exam journey. You've got this!

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