5.10 Financial Reporting Quality

Question 1
A company reports financial results using IFRS. Which of the following *most likely* represents a conservative accounting choice?
A. Assuming longer useful lives for noncurrent assets
B. Increasing life expectancies for retired pension recipients
C. Reducing the allowance for uncollectible accounts receivable

Question 2
Which of the following *best describes* the relationship between the quality of financial reports and the quality of earnings?
A. High quality of earnings indicates a high quality of financial reporting.
B. Low quality of earnings prevents analysts from determining the quality of reporting.
C. High quality of financial reporting allows analysts to determine the quality of earnings.

Question 3
.An analyst suspects a company of manipulating its financials. A trend that could *most likely* be a warning sign is:
A. declining inventory turnover over multiple periods.
B. receivables decreasing as a percentage of total revenue.
C. a net-income-to-cash-from-operating-activities ratio consistently below 1.

Question 4
Which of the following circumstances would *least likely* result in a company issuing financial reports considered to be of low quality?
A. The company is experiencing an exceptionally strong period.
B. Earnings are volatile from period to period due to a competitive industry.
C. The CEO wants to sell the company at a large premium to its current stock price.

Question 5
Adjusted EBITDA *most accurately*:
A. may exclude the impact of equity-based compensation.
B. may be impacted by the choice of depreciation method.
C. is commonly prepared under the same methodology across firms.

Question 6
An analyst gathers the following information on two competitors, concerning their differences in accounting methods.

	Company 1	Company 2
Classification of investments held indefinitely	Available-for-sale	Trading securities
Composition of intangible assets	Majority consists of goodwill	No goodwill
Depreciation method on fixed assets	Straight line	Accelerated

To facilitate proper financial comparison, the analyst should *most appropriately*:
A. adjust Company 2's gross book value of fixed assets.
B. reduce Company 1's net income for fair value investment gains.
C. reduce Company 1's amount of intangible assets by its goodwill balance.

Question 7
Which of the following reporting practices is *most likely* considered aggressive accounting?
A. Presenting pro forma earnings per share (EPS) that are lower than reported EPS.
B. Capitalizing, instead of expensing, in-process research and development (R&D) costs.
C. Using the criteria of available-for-sale securities, rather than trading securities, to treat bond investment gains.

Question 8
Which of the following is *least likely* to increase financial reporting discipline?
A. Auditor reports included as part of the auditing company's consulting services
B. Debt covenants that require the current ratio to be at or above a minimum figure
C. Regulations that enforce disclosure but do not require management to certify financial statements

Question 9
A company reports a significant increase in earnings per share (EPS) for fiscal year 20X8. An analyst examining the annual financial statements determines that the increase arises mostly from sales of noncore fixed assets. The statements are GAAP-compliant in all respects, and the footnotes provide significant details about the sales. The financial statements *most likely* represent:
A. high-quality financial reporting and financial earnings.
B. high-quality financial reporting but low-quality financial earnings.
C. low-quality financial reporting but high-quality financial earnings.

Question 10
High-quality financial earnings are l*east likely* characterized by:
A. detailed pro forma financial statements.
B. sustainable and robust sources of revenue.
C. conservative estimates of useful lives for noncurrent assets.

Question 11
Which of the following accounting choices would *most likely* artificially enhance reported results in the current period?
A. Expensing, rather than capitalizing, long-term asset purchases
B. Decreasing future benefit projections for a goodwill impairment assessment
C. Changing revenue recognition criteria from Free on Board (FOB) destination to FOB shipping

Question 12
A company sells a homogeneous product and many of its sales are on credit. An analyst is reviewing the company's financial statements for the past three years. Which of the following would an analyst *least appropriately* consider to be a warning sign concerning the company's financial reporting?
A. Inventory turnover has declined each year over the period.
B. The company routinely recognizes revenue using bill-and-hold arrangements.
C. The ratio of cash flow from operations to net income is consistently more than 1.0.

Question 13
Which of the following is *least likely* considered a warning sign for financial manipulation?
A. A gain from sale of assets reported in operating income
B. A loss from a rare lawsuit reported as a nonoperating loss
C. Receivables are increasing much faster than reported revenue

Question 14
Which of the following is *most likely* to be considered an aggressive accounting choice?
A. Increasing the estimate for bad debt expense
B. Using the percentage-of-completion instead of completed contract method
C. Raising post-retirement life expectancy assumptions for a defined benefit plan

Question 15
A manager collects the following information (in USD) on a company that reports under US GAAP:

Inventory purchased

Cost in USD

Month Purchased	Units	Unit Cost	Total Cost
January	20	100	2,000
March	30	300	9,000
August	50	400	20,000
November	100	600	60,000
Total	200		91,000

The company has no inventory at the beginning of the year and 100 units in inventory at the end of the year. Management is under pressure to meet its year-end earnings target and is considering changing its accounting methods. Which change in inventory costing method is *most likely* to increase earnings?
A. LIFO to FIFO
B. Periodic weighted average to LIFO
C. FIFO to periodic weighted average

Question 16
Which of the following is *most likely* considered a warning sign in a company's financial reporting?
A. Classification of substantial expenses as recurring
B. Substantially exceeding fourth-quarter earnings guidance regularly
C. Increasing trend in levels of operating cash flow relative to net income

Question 17
Which of the following actions taken by management can *most likely* mislead investors by improving the appearance of net cash from operating activities?
A. Delaying payment to suppliers
B. Expensing instead of capitalizing asset costs
C. Disposing of outdated capital equipment at a gain

Question 18
A company's chief financial officer accelerated revenue recognition during the last month of the year to earn a sizable personal bonus. Which of the following conditions conducive to issuing low-quality financial reports *best* explains this action?
A. Opportunity
B. Motivation
C. Rationalization