Q-1. Solution: C.

In the spectrum of financial reporting quality, financial reports that depart from general accepted accounting principles are considered to be of lower quality than those that reflect biased accounting choices. Financial reports that reflect unsustainable earnings, such as one-time gains, can still be of high quality if they state the situation clearly.

Q-2. Solution: C.

Financial statements should be adjusted for differences in accounting standards (as well as accounting and operating choices). These adjustments should be made prior to common-size and ratio analysis.

Q-3. Solution: C.

NI=$200 million and CFO=$120, so NI>CFO, and CFO=NI + dep. /amor. - gain + loss - changes in current assets + changes in current liabilities.

Tightened credit policies and increased collection efforts will increase CFO; and to sell a long-term investment for an amount equal to book value at the end of the year is an investment activity, so increased raw materials inventory in anticipation of increased sales at the end of the year will lead to CFO decreased, and less than NI.

Q-4. Solution: A.

Negative screening, which refers to the practice of excluding certain sectors or companies that violate accepted standards in such areas as human rights or environmental concerns, is the most common ESG investment strategy (implementation method).

Q-5. Solution: A.

Under good corporate governance practices the compensation committee develops remuneration policies for directors as well as key executives. The audit committee, not the compensation committee, would be involved in the remuneration of the external auditors.

C is incorrect. The committee should be composed of independent (non-executive) members only.

B is incorrect. The audit committee is responsible for proposing the external auditor’s remuneration.