Question #1 of 26

Samantha Cameron, CFA, is analyzing the financial reporting quality of Redd Networks. Cameron examines how the company is responding to strict debt covenants and investigates executives' holdings of stock and options in the firm, which are believed to be quite high. Which condition that may lead to low-quality financial reporting is Cameron investigating?

A) Opportunity.

B) Rationalization.

C) Motivation.

Question #2 of 26

Aggressive accounting choices by management are *most likely* to:

A) produce decision-useful financial reporting.

B) report sustainable earnings.

C) comply with generally accepted accounting principles.

Question #3 of 26

An IFRS-reporting firm includes in its financial statements a measure that is not defined under IFRS. The firm is *least likely* required to:

A) define and explain the relevance of this measure.

B) show this measure for all periods presented.

C) reconcile this measure with the most comparable IFRS measure.

Question #4 of 26

Which of the following accounting warning signs is *most likely* to indicate manipulation of reported operating cash flows?

A) Capitalizing purchases that comparable firms typically expense.

B) Higher estimated salvage values than are typical in a firm’s industry.

C) More aggressive revenue recognition methods than comparable firms.

Question #5 of 26

On a spectrum for assessing financial reporting quality, which of the following represents the highest quality?

A) Reporting is compliant with GAAP and decision useful but earnings are not sustainable.

B) Reporting is not compliant with GAAP but the numbers presented reflect the company's actual activities.

C) Reporting is compliant with GAAP but reporting choices and estimates are biased.

Question #6 of 26

If management is manipulating financial reporting to avoid breaching an interest coverage ratio covenant on the firm's debt, they are *most likely* to:

A) capitalize leases.

B) understate assets.

C) overstate earnings.

Question #7 of 26

Under which inventory cost flow assumption is a firm *most likely* to show an unusual increase in gross profit margin by sales in excess of current period production?

A) FIFO.

B) Average cost.

C) LIFO.

Question #8 of 26

In which of the following situations is management *most likely* to make conservative choices and estimates that reduce the quality of financial reports?

A) Management's compensation is closely tied to near-term performance of the firm's stock.

B) Earnings for a period will be higher than analysts' expectations.

C) The firm must meet accounting benchmarks to comply with debt covenants.

Question #9 of 26

A significant increase in days payables above historical levels is *most likely* associated with:

A) an unsustainable increase in reported earnings.

B) an increase in net working capital.

C) low quality of the cash flow statement.

Question #10 of 26

If a firm's financial reports are of low quality, can users of the reports assess the quality of the firm's earnings?

A) No, because low-quality financial reports are not useful for assessing the quality of earnings.

B) Yes, because if financial reports are of low quality, earnings are also of low quality.

C) Yes, because users can assess earnings quality independently of financial reporting quality.

Question #11 of 26

Management is *most likely* to be motivated to produce low-quality financial reports when:

A) managers' compensation is unrelated to the firm's share price.

B) the firm is not required to abide by loan covenants.

C) earnings are less than analysts expect.

Question #12 of 26

Mechanisms that enforce discipline over financial reporting quality *least likely* include:

A) counterparties to private contracts.

B) accounting standard-setting bodies.

C) government securities regulators.

Question #13 of 26

Which of the following actions is *least likely* to increase earnings for the current period?

A) Decreasing the salvage value of depreciable assets.

B) Recognizing revenue before fulfilling the terms of a sale.

C) Selling more inventory than is purchased or produced.

Question #14 of 26

Which of the following is *most accurately* described as a characteristic of a firm's quality of earnings?

A) Relevance.

B) Completeness.

C) Sustainability.

Question #15 of 26

Conditions that may cause firms to issue low-quality financial reports are *best* described as:

A) opportunity, motivation, and rationalization.

B) inappropriate ethical standards and failing to correct known reportable conditions.

C) unstable organizational structure and deficient internal controls.

Question #16 of 26

Which of the following is *least likely* one of the combinations of the quality of financial reporting and quality of reported earnings along the spectrum of financial report quality?

A) Reporting is compliant with GAAP, but the amount of earnings is actively managed to smooth earnings.

B) Reporting is not compliant with GAAP, although reported earnings are sustainable and adequate.

C) Reporting is not compliant and includes numbers that are fictitious or fraudulent.

Question #17 of 26

Aggressive accounting choices include:

A) classifying interest paid as an investing cash flow.

B) increasing the valuation allowance of a deferred tax asset.

C) decreasing the estimated useful life of an asset.

Question #18 of 26

A spectrum for assessing financial reporting quality should consider:

A) quality of earnings only.

B) quality of financial reports only.

C) both quality of financial reports and quality of earnings.

Question #19 of 26

Which of the following is one of circumstances that is conducive to issuing low-quality financial reports?

A) Earnings per share are highly variable from year to year.

B) Balance sheet values are likely to violate debt covenants.

C) There is a large range of acceptable accounting treatments.

Question #20 of 26

Joe Carter, CFA, believes Triangle Equipment, a maker of large, specialized industrial equipment, has overstated the salvage value of its equipment. This would:

A) understate earnings.

B) overstate liabilities.

C) overstate earnings.

Question #21 of 26

A mechanism to discipline financial reporting quality for securities that trade in the United States that is not typically imposed on security issuers elsewhere is that:

A) management must attest to the effectiveness of the firm's internal controls.

B) the firm must provide a signed statement by the person responsible for preparing the financial statements.

C) financial statements must be audited by an independent party.

Question #22 of 26

Which of the following is *least likely* to be a motivation for managers to issue financial reports of low quality?

A) Enhancement of the manager's career.

B) Keeping earnings above the same period in the prior year.

C) Accounting controls are weak within the company.

Question #23 of 26

With regard to the goal of neutrality in financial reporting, accounting standards related to research costs and litigation losses should be viewed as:

A) biased toward aggressive financial reporting.

B) biased toward conservative financial reporting.

C) promoting neutral financial reporting.

Question #24 of 26

The quality of a company's reported earnings is low when they:

A) are lower than for the prior-year period.

B) do not conform to GAAP.

C) are not sustainable.

Question #25 of 26

With regard to a firm's financial reporting quality, an analyst should *most likely* interpret as a warning sign a focus by management on an increase in the firm's:

A) asset turnover ratios.

B) pro forma earnings.

C) cash from operations.

Question #26 of 26

Which of the following requirements are *most likely* to create incentives for management to manipulate earnings?

A) Debt covenants.

B) Audit requirements.

C) Disclosure regulations.