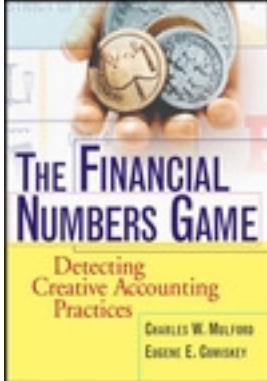


## Review Questions and Final Exam

Course name:	<b>Detecting Creative Accounting Practices</b>
Course number:	1058N
Number of questions:	Review 100 Final exam 100
Prerequisite:	None
Course level:	Basic
Recommended CPE credit:	16 CPE hours
Recommended study time:	16 hours
Course format:	Interactive self study CPE credit calculated as 100% of total study time (i.e. 50 minute hour)
Reference text:	<p><b><i>The Financial Numbers Game</i></b></p> <p>by Charles W. Mulford and Eugene E. Comiskey</p> <p>Softcover: 395 pages</p> <p>ISBN: 0-471-77073-6</p> <p>Publisher: Wiley (September 2005))</p>
	 <p><a href="#">Click to order</a></p>
Subject classification:	Accounting and auditing)
Course updated:	December 3, 2007
Learning objectives:	To identify the steps businesses may take to misstate financial performance and help financial statement users identify those situations where reported results may not be what they seem.
Instructions:	This copy of the exam can be used to answer questions while <b>offline</b> .  Please note that you will still need to <b>enter your answers online</b> by logging into the course system with your User ID and Password.

Exam Name: Detecting Creative Accounting Practices  
--Review Questions

- 1) Earnings management is the active manipulation of earnings toward a predetermined target.  
True  
False
- 2) Higher reported earnings can convey an impression of improved credit quality for a company.  
True  
False
- 3) "Fictitious revenue recognition" refers to recognizing revenue for a legitimate sale in a period prior to that called for by generally accepted accounting principles.  
True  
False
- 4) Per the text, "aggressive accounting" is a forceful and intentional choice and application of accounting principles in an effort to achieve desired results.  
True  
False
- 5) Under GAAP, companies are relatively free to choose the inventory method they wish to use.  
True  
False
- 6) The application of accounting principles in the area of software revenue recognition has recently become more flexible.  
True  
False
- 7) The act of recording a restructuring charge denotes the aggressive application of accounting principles.  
True  
False
- 8) Taking a "big bath" makes the balance sheet more conservative.  
True  
False
- 9) "Purchased in-process research and development" should be capitalized under certain circumstances.  
True  
False
- 10) When accounting errors in financial statement amounts are discovered, adjustments to correct the financial statements may call for restatements of prior-period amounts.  
True  
False

- 11) The actions taken by the SEC against fraudulent financial reporting are criminal actions.  
True  
False
- 12) A "change in estimate" occurs when management reassesses its judgment as to estimates related to assets or liabilities.  
True  
False
- 13) "Cookie jar reserves" occur when a company capitalizes and reports assets as significant portions of expenditures using unduly optimistic assumptions.  
True  
False
- 14) Abusive earnings management involves the use of various forms of gimmickry to distort a company's true financial performance in order to achieve a desired result.  
True  
False
- 15) The most common class of earnings management techniques involves simply using the flexibility that exists in GAAP.  
True  
False
- 16) Changing depreciation methods is a potential earnings management technique.  
True  
False
- 17) Sneaky, Inc., holds its books open and continues to record shipments that clearly belong in subsequent periods. This is an example of "premature revenue recognition."  
True  
False
- 18) SEC earnings management evidence is based on statistical models.  
True  
False
- 19) Evidence of earnings management from descriptive studies show that small reported losses are rare.  
True  
False
- 20) An earnings target typically will be seen as not met if the earnings shortfall is covered by nonrecurring increases in earnings.  
True  
False
- 21) A traditional view is that volatility in reported earnings is a sign of heightened risk.  
True  
False

- 22) Fraudulent financial reporting includes unintentional misstatements in financial statements.  
True  
False
- 23) Income smoothing includes taking steps to reduce and “store” profits during good years for use during slower years.  
True  
False
- 24) "Big bath" charges occur when companies use large restructuring charges to clean up their balance sheets.  
True  
False
- 25) The SEC chairman Arthur Levitt noted that U.S. capital market supremacy is based on the reliability and transparency of financial statements.  
True  
False
- 26) One of the criteria that must be met before revenue can be recognized is that the seller’s price to the buyer is fixed or determinable.  
True  
False
- 27) The Securities Act of 1933 established the SEC.  
True  
False
- 28) The SEC plays a major role in the development of accounting principles.  
True  
False
- 29) The anti-fraud provisions of the Securities Acts are very specific.  
True  
False
- 30) Small companies with assets and revenue less than \$100 million are more at risk for fraudulent financial reporting than larger companies.  
True  
False
- 31) The Division for Corporation Finance was a special committee formed in 1985 to investigate the underlying causes of fraudulent financial reporting.  
True  
False
- 32) Materiality is the magnitude of a financial statement item’s effect on a company’s overall financial condition and operations.  
True

False

33) Porker Farms ships piglets to a customer and recognizes the sale. The purchaser receives an oral right-of-return agreement. Porker Farms does not record a provision for expected returns. The author's survey of financial professionals indicated that most professionals would believe Porker Farms has NOT followed GAAP.

True

False

34) Company X expands production beyond current requirements in order to capitalize more overhead into inventory and by so doing increase incentive compensation for company officers.

This type of action does not raise a GAAP issue, according the author's survey.

True

False

35) Books are held open for several days after the close of the year to record additional sales for that (past) year during the first few days of the new year. The survey results indicated that this action is considered fraudulent financial reporting.

True

False

36) Sales are recognized on goods shipped to reseller customers who are not credit-worthy. No related allowance for bad debt is recorded. Most survey respondents believed this was fully in compliance with GAAP.

True

False

37) According to the earnings management survey, earnings management that is based on the timing of revenue recognition was the most commonly observed earnings-management technique.

True

False

38) The results of the survey reveal that changes in accounting policies and practices was the least commonly observed earnings management technique.

True

False

39) Bill-and-hold sales are an example of a timing of operating expenses earnings management technique.

True

False

40) Most of the cases of abusive earnings management, which became the subjects of accounting and auditing enforcement releases of the SEC, had gone on for years without detection.

True

False

41) Review of cash-flow and accrual relationships was the number one technique for the detection of earnings management.

True

False

42) Looking for changes in revenue and expenses in the fourth quarter is an example of using trend analysis for earnings management detection.

True

False

43) The survey reveals that the reduction in earnings volatility is the most frequently mentioned benefit of earnings management.

True

False

44) Channel stuffing is a sales agreement where goods that have been sold are not shipped to a customer but are segregated outside of other inventory of the selling company.

True

False

45) Reported revenue and its rate of growth directly affect the assessment of earning power.

True

False

46) Pinnacle Micro, Inc. shipped products after the end of the reporting period to fill orders received prior to the end of that period. In order to include the late shipments in sales for the period just ending, the books were left open well into the new period.

This is an example of fictitious revenue recognition.

True

False

47) With both premature and fictitious revenue, revenue has been improperly reported on the income statement.

True

False

48) One of the criteria that must be met before software revenue can be recognized is that the delivery has occurred.

True

False

49) A separate agreement that effectively neutralizes the purchase transaction between the company and its customer is an improper side letter.

True

False

50) A related party entity is an entity whose management or operating policies can be controlled or significantly influenced.

True

False

- 51) One of the criteria that must be met before revenue can be recognized in advance of shipment is that the risks of ownership have passed to the buyer.  
True  
False
- 52) Collectibility hinges first and foremost on transacting business with a creditworthy customer.  
True  
False
- 53) Revenue that is recognized in a premature or fictitious manner is often not collected.  
True  
False
- 54) The Completed-Contract method is a contract accounting method that recognizes contract revenue and contract expenses as progress is made toward completion.  
True  
False
- 55) The "matching principle" ties expense recognition to revenue recognition.  
True  
False
- 56) Costs related to one-time activities such as introducing a new product or service are called start-up costs.  
True  
False
- 57) Research and development costs, excluding expenditures on software development after technological feasibility is reached, are capitalized.  
True  
False
- 58) Costs incurred to register a patent derived from successful R&D are considered R&D costs.  
True  
False
- 59) Direct-response advertising can be capitalized under GAAP policy.  
True  
False
- 60) GAAP provides no specific guidance as to the appropriate period of amortization for long-lived assets.  
True  
False
- 61) Restructuring charges are closely related to charges taken for asset impairment.  
True  
False
- 62) A restructuring charge is a recurring charge.  
True

False

63) Software development costs incurred in developing software for internal use are capitalized once the preliminary project stage is completed.

True

False

64) An undervaluation of liabilities will inflate earnings temporarily.

True

False

65) Improperly valuing accounts receivable can boost earnings, even if revenue is being properly recognized.

True

False

66) One of the creative accounting methods used to overvalue inventory is to increase the reported valuation of inventory without changing its physical count.

True

False

67) An inventory write-down is rarely necessary and usually a sign of "creative accounting."

True

False

68) LIFO assumes that inventory costs included in cost of goods sold were of the last units purchased during a year.

True

False

69) An investment in debt securities held to maturity is classified as "debt securities held for trading purposes."

True

False

70) A classification of an investment in a debt security cannot be altered at a later date.

True

False

71) A search for under accrued expenses should include a careful review of the trend in accrued expenses payable.

True

False

72) When a company's effective tax rate departs significantly from the 35% to 40% range, reasons for the departure should be noted.

True

False

73) For traded securities, fair value and market value are synonymous.

True

False

74) The two basic income statement formats under current practice and GAAP requirements are the single-step and multi-step.

True

False

75) Any gain or loss realized on debt retirement should be classified as an extraordinary item.

True

False

76) The retroactive restatement method is the most common method to report a change in accounting principle.

True

False

77) The accounting for changes in estimates is handled on a prospective basis.

True

False

78) The determination of operating income permits a degree of flexibility.

True

False

79) According to the Emerging Issues Task Force (EITF), how companies report revenue is a minor issue, because investors usually concentrate on the "bottom line."

True

False

80) The EITF reached a consensus that calls for the inclusion of billings for shipping and handling in sales revenue.

True

False

81) It is common practice to net miscellaneous items of nonoperating revenue, gain, expense and loss.

True

False

82) The SEC supports the idea that materiality can be assessed simply on the basis of an ad hoc numerical 8% threshold.

True

False

83) A measure of earnings that are derived by making adjustments to net income or loss found in the GAAP statement is "core earnings."

True

False

84) A financial covenant is a feature of a debt or credit agreement that is designed to protect the lender or creditor.

True  
False

85) Pro-forma results are usually calculated in accordance with generally accepted accounting procedures (GAAP).

True  
False

86) Adaptations of net income are generically referred to as pro-forma earnings.

True  
False

87) EBITDA is an accepted GAAP measure.

True  
False

88) With the growth in the frequency of nonrecurring items, pro-forma or adjusted earnings can be helpful in determining the trends in basic operating profitability.

True  
False

89) Pro-forma measures of earnings provide trustworthy measures of a company's financial health.

True  
False

90) The Frisbee company realizes that their primary customers, aging baby boomers, are developing increasingly poor eyesight. As a result, management decides to restructure all ad campaigns to target sales of larger Frisbees to older customers, primarily through ads in Readers' Digest and AARP Magazine. A restructuring charge may be incurred in connection with the abandonment of the small Frisbee manufacturing and related marketing efforts.

True  
False

91) For creditors, a sustainable cash-flow stream is sought as a primary source of debt service.

True  
False

92) The purpose of the statement of cash flow per FASB is to support the other accrual-based statements.

True  
False

93) Operating cash flow is more likely to be sustained than other sources of cash that may be provided from investing activities or financing activities.

True  
False

94) Separate disclosure of cash provided by the continuing operations and discontinued operations of a company is required by GAAP.

True

False

95) For a meaningful measure of operating cash flow only income taxes on continuing operations should be included.

True

False

96) Foreign-currency gains and losses are included in net income and, to the extent they are unrealized, will be removed in calculating operating cash flow.

True

False

97) According to the Emerging Issues Task Force (EITF), tax benefits from nonqualified employee stock options should be included with operating cash flow.

True

False

98) Cost capitalization decreases earnings.

True

False

99) Increases in earnings obtained through creative accounting practices will usually increase operating cash flow.

True

False

100) "Adjusted cash flow provided by continuing operations" is cash flow provided by operation activities adjusted to provide a more recurring, sustainable measure.

True

False

Exam Name: Detecting Creative Accounting Practices  
-- Final Exam

1) Income smoothing is defined as:

- a) The active manipulation of earnings toward a predetermined target.
- b) Intentional misstatements in financial statements done to deceive users.
- c) Hiding high payouts to CEOs.
- d) A form of earnings management designed to remove peaks and valleys from a normal earnings series.

2) The use of creative accounting practices to improve reported financial measures can lead to lower corporate borrowing costs.

True

False

3) Premature revenue recognition refers to recognizing revenue for a legitimate sale in a period prior to that called for by GAAP.

True  
False

- 4) The costs of additional regulation borne by large and high-profile firms are called:
- a) Borrowing costs.
  - b) Bonus plan costs.
  - c) Political costs.
  - d) Share-price costs.
- 5) When determining inventory cost, it is an SEC requirement that public companies using FIFO disclose the excess of replacement cost.
- True  
False
- 6) Software companies must ship their software products before recognizing revenue.
- True  
False
- 7) In the Sunbeam Corporation corporate restructuring example (page 27):
- a) Sunbeam recorded unusually low restructuring costs to reduce future-year expenses.
  - b) The restructuring charge was the only instance where Sunbeam applied accounting principles aggressively.
  - c) Sunbeam intentionally overestimated the costs of its restructuring.
  - d) Write-downs of inventory were properly included in the costs of the restructuring.
- 8) Writing down assets in a wholesale fashion in a bad year to clean the balance sheet is called:
- a) A special charge.
  - b) Storing earnings
  - c) Cleaning house.
  - d) A big bath.
- 9) Zigbot, Inc., purchases a small software company with in-process software development and the software project has reached technological feasibility. The cost associated with the in-process software development should be expensed.
- True  
False
- 10) Jeremy Irony accidentally omitted a liability from accrued liabilities when he prepared the work papers for his company's quarterly report. Most likely this will simply be considered an error and the company will just need to restate these prior quarter results, if the amount is material.
- True  
False
- 11) Fraudulent financial reporting entails a premeditated intent to deceive in a material way.
- True  
False
- 12) A catalyst that might cause the auditors to more closely review a company's reporting practices is:
- a) Lack of turnover in company management.
  - b) Improving economic fundamentals.

- c) Change in auditors.
  - d) Not being invited to the company holiday party.
- 13) An overly aggressive accrual of operating expenses and the creation of liability accounts done in an effort to reduce future-year operating expenses is called a:
- a) Cumulative-effect adjustment.
  - b) Bill and hold practice.
  - c) Write-down.
  - d) Cookie jar reserve.
- 14) Earnings management is the active manipulation of accounting results for the purpose of creating an altered impression of business performance.
- True
  - False
- 15) Which of the following conditions might **REDUCE** fraudulent financial reporting?
- a) Management bonuses based on meeting earnings goals.
  - b) Weak internal controls.
  - c) Inexperienced management.
  - d) Strong board of directors.
- 16) Potential earning management techniques include:
- a) Continued use of the same depreciation method.
  - b) Never changing actuarial assumptions for pensions.
  - c) Changing the useful lives used for depreciation purposes.
  - d) Changing accounting software systems.
- 17) The premature recognition of revenue is an uncommon form of abusive earnings management.
- True
  - False
- 18) Academic research on earnings management has never found evidence of the presence of earnings management.
- True
  - False
- 19) Descriptive studies focus on:
- a) Bonus maximization.
  - b) Incentive compensation of managers.
  - c) How management describes how they avoided getting caught when they created fraudulent financial statements.
  - d) Possible incentives to achieve specific earnings outcomes.
- 20) The key to the effectiveness of projections-oriented earnings management is that both analysts and the market accept the managed results as indicative of the firm's real financial performance.
- True
  - False

- 21) According to the author, everyone agrees that earnings management is always bad.  
True  
False
- 22) Sneaky, Inc. wanted to reduce acquisition-year earnings and boost future-year earnings. After acquiring another company, they allocated as much of the purchase price as possible to expense, by creating overly aggressive accruals of future operating expenses. Sneaky used \_\_\_\_\_ to accomplish their objective.  
a) Income smoothing.  
b) Administrative proceeding.  
c) A bogey.  
d) Creative acquisition accounting.
- 23) A mental state embracing intent to deceive, manipulate or defraud is called:  
a) Bi-polar.  
b) A covenant.  
c) Scienter.  
d) GIP.
- 24) \_\_\_\_\_ was NOT recognized as one of the creative accounting practices identified by the SEC.  
a) Big bath charges  
b) Cookie jar reserves  
c) Pineapple upsidedown assets  
d) Revenue recognition
- 25) According to the author, enhancing outside auditing should increase public confidence in financial reporting.  
True  
False
- 26) Which is one of the criteria that must be met before revenue can be recognized?  
a) The revenue has been collected and deposited.  
b) The seller's price to the buyer has been narrowed down to a reasonable range.  
c) Delivery is expected to occur in the near future.  
d) There is persuasive evidence of the arrangement.
- 27) The Securities Act of 1933 was designed to protect the investing public from fraudulent practices in the purchase and sale of newly issued securities.  
True  
False
- 28) Violations involving financial reporting that are deemed to be a misrepresentation or omission of important information would fall under the jurisdiction of:  
a) NRA  
b) IRS  
c) NASBA  
d) The SEC's Division of Enforcement.

- 29) Financial reports are considered to be fraudulent when they violate the anti-fraud provisions of the Securities Act.  
True  
False
- 30) An attribute of companies at risk for fraudulent financial reporting is:  
a) Lack of family relationships among directors.  
b) Annual revenue greater than \$500 million.  
c) Board of directors dominated by individuals with significant equity ownership.  
d) Audit committee with fewer than 10 members.
- 31) The SEC generally establishes accepted accounting principles.  
True  
False
- 32) An item on a financial statement is considered material when its size will likely influence a decision of an investor or creditor.  
True  
False
- 33) Goods are shipped to a customer and a sale is recognized. The purchaser is provided an oral right-of-return agreement but no provision for expected returns is recorded. All of the following EXCEPT \_\_\_\_\_ affect the determination if the lack of a provision for returns is acceptable.  
a) Whether the amounts are material  
b) Whether they expected any returns  
c) Whether management was acting with intent to deceive  
d) Whether the goods could be returned in the current fiscal year.
- 34) Production is expanded beyond current requirements in order to capitalize more overhead into inventory and by so doing increase incentive compensation for company officers. In the survey of financial professionals cited, most viewed this action as fraudulent financial reporting.  
True  
False
- 35) Books are held open for several days after the close of the year to record additional sales for the year. In the survey of financial professionals cited, most viewed this action as fraudulent financial reporting.  
True  
False
- 36) In the survey of financial professional, respondents correctly classified all potentially fraudulent actions, without exception.  
True  
False
- 37) The most common earnings management technique observed by the survey participants was:  
a) Timing of revenue recognition.  
b) Change in inventory accounting method.  
c) Timing of expense recognition.  
d) Change in accounting policy.

- 38) Changes in accounting policies represented \_\_\_\_\_% of the total earnings-management techniques that were reported from the survey?
- a) 3.5%
  - b) 30%
  - c) 50%
  - d) 75%
- 39) Which of the following is an example of timing operating expenses earnings management technique?
- a) Special charges offsetting gains.
  - b) Premature booking of revenue.
  - c) Channel stuffing.
  - d) Underestimation of allowances.
- 40) Instances of abusive earnings management usually involve the participation and collusion of top management.
- True
  - False
- 41) Which technique was rated number one of the separately identified detection techniques?
- a) Cash-flow and accrual relationships.
  - b) Day statistics.
  - c) Trend analysis.
  - d) Footnote review.
- 42) Comparing revenue growth versus EPS growth is an example of:
- a) Footnote analysis.
  - b) Accrual relationships
  - c) Cutoff testing.
  - d) Trend analysis.
- 43) Survey respondents identified the number one reason that earnings management can be helpful as:
- a) Providing a share-price benefit.
  - b) Helping to meet forecasts.
  - c) Reducing of earnings volatility.
  - d) Rationalizing expectations
- 44) Shipments of product to distributors who are encouraged to overbuy under the short-term offer of deep discounts are called:
- a) Big bath transactions.
  - b) Consignment
  - c) LIFO dipping
  - d) Channel stuffing
- 45) For many start-up operations that have not yet become profitable, valuation is often calculated as a multiple of revenue.
- True
  - False

- 46) Revenue recognized for goods that have been ordered but have not been shipped at the time of recognition would be considered by most to be fictitious revenue.  
True  
False
- 47) Cover-up activities commonly found among cases of fictitious revenue recognition include:  
a) Changing shipping dates.  
b) Backdating invoices.  
c) Creating false records  
d) All of the above.
- 48) In its most elemental form, revenue should be recognized when it is earned and realized or realizable.  
True  
False
- 49) Which of the following is true about side letters?  
a) They usually specify a higher actual purchase price than what was originally agreed to.  
b) They frequently require earlier delivery of the product than the original agreement.  
c) They are used to negate some or all terms of the disclosed agreement.  
d) They always negate the sale under GAAP.
- 50) The issue with related-party revenue is whether a sale would have taken place in the absence of the affiliation between the two parties.  
True  
False
- 51) Criteria for recognizing revenue in advance of shipment include:  
a) The sale must be to a related party.  
b) The seller retains specific performance obligations (other than shipping the product) such that the earning process is not complete.  
c) The seller must request that the transaction be on a bill-and-hold basis.  
d) The goods must be complete and ready for shipment.
- 52) Slinky, Inc. sells 1 million blue slinkies to a "mom and pop" company with unknown credit. Slinky, Inc. gives the company four years to pay for the slinkies. Collectibility of payment for the slinkies is most likely "reasonably assured" and should not be questioned, according the guidelines in the text.  
True  
False
- 53) Unusual increases in accounts receivable commonly accompany questionable revenue.  
True  
False
- 54) Revenue recognized for a confirmed sales transaction in a period prior to that called for by GAAP is called \_\_\_\_\_.  
a) Confirmed revenue.  
b) Questionable revenue.  
c) Premature revenue.  
d) Pre-GAAP revenue.

- 55) The net effect of amortizing capitalized costs over extended periods is to postpone expenses to future periods and boost current-period earnings.  
True  
False
- 56) Start-up costs must be capitalized because of the link between current costs and future revenue.  
True  
False
- 57) \_\_\_\_\_ costs would NOT be expensed currently.  
a) Selling  
b) Advertising  
c) Administrative  
d) Software development
- 58) Capitalization is permitted for costs incurred to register or successfully defend a patent.  
True  
False
- 59) Capitalizing direct-response advertising costs is considered an aggressive capitalization policy.  
True  
False
- 60) The process of spreading costs over several reporting periods is commonly called any of the following EXCEPT:  
a) Depletion.  
b) Amortization.  
c) Acquisition.  
d) Depreciation.
- 61) If a board of directors must approve a decision to close 30 stores, then a charge to close those stores should not be recorded until board approval is obtained.  
True  
False
- 62) What principle dictates that expenses are to be matched with revenue?  
a) The Checkpoint Principle  
b) The Bottom Line Principle.  
c) The High School Principle.  
d) The Matching Principle.
- 63) An impairment loss is a recurring charge taken annually for damaged equipment or facilities.  
True  
False
- 64) Which of the following could cause current period earnings to be overstated?  
a) Record overstated receivables.  
b) Write down inventory.

- c) Overstate pending litigation liability.
  - d) Adjust cost of goods sold to a higher amount.
- 65) A company that chooses to boost earnings temporarily can do so by minimizing the expense recorded as the provision for doubtful accounts.
- True
  - False
- 66) An overvaluation of inventory will:
- a) Overstate costs of goods sold.
  - b) Not impact the balance sheet.
  - c) Overstate net income.
  - d) Not impact earnings.
- 67) Inventory write-downs are generally only necessary if a company is discontinuing a product.
- True
  - False
- 68) When inventory costs are rising, using LIFO instead of FIFO will cause:
- a) Higher net income.
  - b) Lower cost of goods sold.
  - c) Higher accounts receivable.
  - d) Lower net income.
- 69) Debt securities held for trading purposes are reported at book value.
- True
  - False
- 70) Classification of debt and equity securities:
- a) Cannot be altered if circumstances change.
  - b) Is determined by the type of securities and does not permit the use of management judgment.
  - c) Should be made at the time of acquisition.
  - d) Does not allow for any creative accounting practices.
- 71) When operations-related expenses are under accrued, future earnings will be affected by higher than normal expense levels.
- True
  - False
- 72) GAAP requires that public companies provide a reconciliation of the statutory federal income tax rate to the effective income tax rate on income from continuing operations.
- True
  - False
- 73) A debt or equity security bought and held for sale in the near term to generate income on short-term price changes is a(n) \_\_\_\_\_ security.
- a) Available-for-sale
  - b) Nonmarketable
  - c) Held-to-maturity

d) Trading

74) The financial numbers game is played principally by accelerating or decelerating the recognition of revenue, gains, expenses and/or losses.

True

False

75) To be classified as extraordinary, an item of revenue must be recurring.

True

False

76) Accounting changes fall into three primary categories. Which of the following is NOT one of the categories?

a) Changes in accounting principle.

b) Changes in reporting entities.

c) Changes in management.

d) Changes in estimate.

77) A change in accounting principle:

a) Can be adopted at will if needed to improve current earnings.

b) Is always discretionary.

c) Does NOT require a reference in the auditor's report.

d) Can be reported using either the cumulative-effect or retroactive restatement method.

78) Non-recurring items CAN be included in operating income under GAAP.

True

False

79) If the company is paid by commission only, that company should record revenue as the amount billed the customer, less the amount paid to the supplier.

True

False

80) Gross-revenue reporting indicators include:

a) The company receives a % commission on the sale.

b) The supplier drop ships the product.

c) The company purchases inventory for resale and warehouses the inventory.

d) The company is required to charge a supplier specified price.

81) The common practice of netting miscellaneous items of nonoperating revenue, gain, expense, and loss may increase the likelihood that important information is overlooked in assessing financial performance.

True

False

82) SEC guidance indicates which of the following would most likely be considered immaterial?

a) The misstatement masks a change in earnings trend.

b) The misstatement affects the company's compliance with loan covenants.

c) The misstatement changes positive net income into a loss.

d) The misstatement causes accrued liabilities related to office expense to be understated by \$1,000.

- 83) A measure of earnings that includes only the results of the primary operating activities of the firm is called:
- a) Permanent earnings
  - b) Pro-forma earnings
  - c) Core earnings
  - d) Sustainable earnings
- 84) Opportunistic behavior involves using the flexibility inherent in GAAP to alter earnings so as to achieve desired outcomes.
- True
  - False
- 85) With pro-forma measures of earnings:
- a) Pro-forma net income is a required GAAP disclosure.
  - b) "Best practice" guidelines indicate that pro-forma results cannot be and should not be reconciled to GAAP results.
  - c) Pro-forma measures of financial performance employ GAAP information, but they are decidedly non-GAAP measures.
  - d) Pro-forma earnings must be calculated using GAAP for publicly traded companies.
- 86) One of the most common pro-forma numbers is:
- a) Net inventory value
  - b) Earnings after taxes, but before salaries expense
  - c) Gross revenue
  - d) Earnings before interest, taxes, depreciation, and amortization.
- 87) "Adjusted or sustainable earnings" is considered a GAAP measure.
- True
  - False
- 88) Movie Star Wigs, Inc. decided to discontinue wig delivery and use the good old U.S. Post Office instead. They sold their fleet of Prius delivery vehicles and recognized a gain of \$75K. This gain should be included in "core earnings" for Movie Star Wigs.
- True
  - False
- 89) Earnings before depreciation and deferred taxes (EBDDT) is used principally by firms in which industry?
- a) Accounting and legal
  - b) Oil and gas
  - c) Manufacturing
  - d) Real estate
- 90) The term permanent earnings is used interchangeably with:
- a) Friendly earnings
  - b) Nonrecurring earnings
  - c) Sustainable earnings
  - d) Investment earnings
- 91) Which of the following is true about cash flow?

- a) The FASB believes the purpose of the statement of cash flow is to reliably predict future cash flows.
- b) "Free cash flow" is money generated from loans.
- c) Fixed assets, such as plant and equipment are considered "cash equivalents" because they can be sold for cash.
- d) Operating cash flow is a key measure of a company's ability to generate a sustainable cash flow.

92) In the view of the Financial Accounting Standards Board (FASB), information about accrual-based earnings and not cash flow per se is more useful to investors in assessing an investment's cash-flow prospects.

- True
- False

93) When classifying inflows and outflows of cash within the Statement of Cash Flows, \_\_\_\_\_ is included the cash provided by operating activities.

- a) Issues of debt.
- b) Proceeds from sale of property.
- c) Dividend payments.
- d) Interest payments.

94) Calculation of operating cash flow includes all income tax payments.

- True
- False

95) Coat Hangers R Us sold its balsa wood coat hanger manufacturing equipment and recognized a gain. This transaction was not part of operations. Operating cash flow would be reduced by any income taxes paid on this gain.

- True
- False

96) The tax benefits of stock options are to be included in \_\_\_\_\_ in cash-flow statements, per the Emerging Issues Task Force decision reached in 2000.

- a) Financing sources and uses.
- b) Paid in capital.
- c) Off balance sheet financing.
- d) Operating cash flow.

97) Operating cash flow generated by the tax benefits of employee stock options should be removed from operating cash flow before using that measure in analysis.

- True
- False

98) Capitalized costs always reduce operating cash flow.

- True
- False

99) Because earnings altered through creative accounting practices usually do not change operating cash flow, the relationship between earnings and cash flow may help detect creative accounting practices.

- True
- False

100) Cash flow should be adjusted for nonrecurring cash inflows and outflows before it is used to detect creative accounting practices.

True

False