

Chap001 The Economic and Institutional Setting for Financial Reporting

True/False

[QUESTION]

1. The role of financial accounting information is to facilitate economic transactions and to foster efficient allocation of resources among businesses and individuals.

Answer: True

Learning Objective: 01-01

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

Blooms: Remember

Topic: Financial statements—As sources of information

[QUESTION]

2. Financial reports provide information that can reduce investors' uncertainty about the company's opportunities and risks, thereby raising the company's cost of capital.

Answer: False

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

3. *Comparability* across companies allows analysts to identify real economic similarities in and differences between underlying economic events because those similarities or differences are not obscured by accounting methods or disclosure practices.

Answer: True

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: FN Risk Analysis

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

4. Executive compensation contracts seldom contain annual bonus and longer term pay components tied to financial statement results, but instead usually rely on stock options as a means to reward managers in a manner that is less subject to manipulation by management.

Answer: False
Learning Objective: 01-02
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: BB Resource Management
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Understand
Topic: Financial statements—For decision-maker needs

[QUESTION]

5. The public and private sector regulatory agencies establish and enforce financial reporting requirements designed to ensure that companies meet certain minimum levels of financial disclosure.

Answer: True
Learning Objective: 01-03
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: BB Legal
Blooms: Remember
Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

6. Although the SEC has the ultimate legal authority to set accounting principles in the U.S., it has looked to private-sector organizations (e.g., the FASB) to establish and enforce these principles.

Answer: False
Feedback: The SEC retains enforcement authority over financial reporting in the U.S.
Learning Objective: 01-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: BB Legal
Blooms: Remember
Topic: Standard-setting—US GAAP

[QUESTION]

7. Management has considerable discretion over the particular accounting procedures used in the financial statements and over the details contained in related note disclosures.

Answer: True
Learning Objective: 01-01
Learning Objective: 01-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Financial statements—As sources of information

Topic: Management choices—Reporting strategies

[QUESTION]

8. Accounting standard-setting in the U.S. is a technical process and thus little affected by political considerations.

Answer: False

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Remember

Topic: Standard-setting—US GAAP

[QUESTION]

9. The IASB and FASB have worked together to develop a single set of high-quality, understandable, enforceable and globally accepted international financial reporting standards.

Answer: True

Learning Objective: 01-06

Difficulty: 1 Easy

AACSB: Diversity

AICPA: BB Global

AICPA: FN Measurement

Blooms: Remember

Topic: Standards differences—US GAAP and IFRS

[QUESTION]

10. Foreign companies registered with the SEC that use IFRS no longer have to reconcile their financial statements to U.S. GAAP.

Answer: False

Feedback: Form F20 reconciles back to GAAP the earnings and shareholder's equity

Learning Objective: 01-06

Difficulty: 2 Medium

AACSB: Diversity

AICPA: BB Legal

AICPA: FN Measurement

Blooms: Understand

Topic: Standards differences—US GAAP and IFRS

[QUESTION]

11. U.S. GAAP has been criticized as being too “rules-based” thus allowing managers to invent “loopholes” that conform to the letter of a standard but simultaneously violate its spirit.

Answer: True

Learning Objective: 01-05

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Global differences and financial reporting

[QUESTION]

12. The goal of the movement toward international convergence of accounting standards is a single set of accounting standards accepted worldwide and superior to the choices presently available.

Answer: True

Learning Objective: 01-06

Difficulty: 1 Easy

AACSB: Reflective Thinking

AACSB: Diversity

AICPA: BB Global

Blooms: Remember

Topic: Standards differences—US GAAP and IFRS

[QUESTION]

13. Regulators of industries granted monopoly privileges use financial statement data in setting the rates companies are permitted to charge for the services these industries provide.

Answer: True

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Industry

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

14. Owners and managers have an economic incentive to supply the amount and type of financial information that will enable the company to raise capital at the lowest cost.

Answer: True

Learning Objective: 01-03

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

Blooms: Remember

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

15. Financial statement information can help customers monitor a supplier's manufacturing processes and thus evaluate the quality of its products.

Answer: False

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Industry

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

16. The conceptual framework for financial reporting includes the standards of GAAP.

Answer: False

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Industry

Blooms: Remember

Topic: Fundamental concepts of financial reporting

Multiple Choice

[QUESTION]

17. A company's financial statements reflect information about

- a. future projections of sales, expenses, and other future economic events.
- b. product information and competitive positions.
- c. the general economy of the industry in which the company operates.
- d. economic events that affect a company that can be translated into accounting numbers.

Answer: d

Learning Objective: 01-01

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Remember

Topic: Financial statements—As sources of information

[QUESTION]

18. All financial statements:

- a. provide a picture of the company at a moment in time.
- b. describe changes that took place over a period of time.
- c. help to evaluate what happened in the past.
- d. contain the most up to date information about the company.

Answer: c

Learning Objective: 01-01

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Remember

Topic: Financial statements—As sources of information

[QUESTION]

19. A firm's financial statements contain trends that give users insight into the firm's
- a. future market share.
 - b. position within its industry.
 - c. profitability, productivity, and liquidity.
 - d. current market price for common and preferred stock.

Answer: c

Learning Objective: 01-01

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—As sources of information

[QUESTION]

20. The ability to raise additional cash by selling assets, issuing stock, or borrowing more is
- a. financial flexibility.
 - b. a credit risk indicator.
 - c. a stock price predictor.
 - d. one way to project earnings.

Answer: a

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

21. Creditors assess credit risk by comparing a firm's required principal and interest payments to estimates of the firm's current and future
- a. net assets.
 - b. gross income.
 - c. net income.
 - d. cash flows.

Answer: d

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Industry

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

22. Professional analysts need information on a company's future earnings and cash flow to evaluate audit vulnerabilities, to assess debt repayment prospects and to
- certify good values in the stock market.
 - indemnify creditors against losses.
 - certify that no fraud exists in the company.
 - value its equity securities.

Answer: d

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Resource Management

AICPA: BB Industry

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

23. The costs of providing financial information is ultimately borne by
- management.
 - shareholders.
 - auditors.
 - professional analysts.

Answer: b

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Understand

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

24. Which of the following statements is **not** correct regarding a company's financial statements?
- They may present a picture of the company at a moment in time.
 - They may describe changes that took place over a period of time .
 - They reflect economic events that affect the company.
 - They are comparable to the statements of other companies as all publicly held companies follow the very precise science of accounting.

Answer: d

Learning Objective: 01-01

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Remember

Topic: Financial statements—As sources of information

[QUESTION]

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25. Which of the following are correct with respect to information contained in financial statements?

- a. Information asymmetry occurs when management has access to more and better information than do people outside the company.
- b. Financial statements cannot solve the issue of information asymmetry.
- c. Financial statements help solve the issue of information asymmetry.
- d. Financial statements help solve the issue of information asymmetry which is when management has access to more and better information than do people outside the company.

Answer: d

Learning Objective: 01-01

Difficulty: 3 Hard

AACSB: Reflective Thinking

AICPA: BB Industry

Blooms: Remember

Topic: Financial statements—As sources of information

[QUESTION]

26. Which is **not** correct regarding Regulation Fair Disclosure (Reg FD) ?

- a. It helps level the playing field between individual and institutional investors.
- b. It does not limit what management can say in private conversations with analysts or investors.
- c. It was passed by the SEC.
- d. It limits what management can say in private conversations with analysts and investors .

Answer: b

Learning Objective: 01-03

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Remember

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

27. Companies that have projected operating cash flows that are more than sufficient to meet debt payments are

- a. financially flexible.
- b. good credit risk companies.
- c. undervalued.
- d. overvalued.

Answer: b

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

28. Investors who compare a firm's discounted future cash flows to the current market price of a stock are using the

- a. efficient market hypothesis.
- b. market-to-market approach.
- c. fundamental analysis approach.
- d. technical analysis approach.

Answer: c

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

29. A company's financial statements can be used for all of the following purposes **except**

- a. as a scorecard on the company's social responsibility.
- b. as a management report card.
- c. as an early warning signal.
- d. as a measure of accountability.

Answer: a

Learning Objective: 01-01

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Understand

Topic: Financial statements—As sources of information

[QUESTION]

30. The market analysis known as *fundamental* analysis

- a. predicts future trends in the financial drivers of a company's economic success or failure.
- b. relies on price and volume movement of stock.
- c. has no insights about company value beyond current market price.
- d. uses microeconomic data to forecast stock values.

Answer: a

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

31. Investors who follow a fundamental analysis approach

- a. determine the value the company's assets would yield if sold individually.
- b. estimate the value of a stock by assessing the amount, timing, and uncertainty of future cash flows that will accrue to the issuing company.
- c. assess the company's ability to meet its debt-related financial obligations.
- d. assess the company's ability to raise additional cash by selling assets, issuing stock, or borrowing more.

Answer: b

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

32. In designing audit procedures the auditor will include all of the following **except**:

- a. Industry conditions.
- b. Global economic trends.
- c. Assessing the reasonableness of the numbers in relation to the company's activities.
- d. Fraud risk factors that may be present.

Answer: b

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

33. Analytical review procedures include all of the following **except**

- a. simple ratio and trend analysis.
- b. complex statistical techniques.
- c. general reasonableness tests.
- d. comparison of the company's reported financial results to benchmarks established by the SEC.

Answer: d

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

34. Relevant financial information

- a. is free from bias and error.
- b. is measured in a similar manner among different companies.
- c. can be independently verified.
- d. is capable of making a difference in a decision.

Answer: d

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

35. To achieve faithful representation, the financial information must be

- a. consistent, unbiased, and relevant.
- b. relevant, comparable, and timely.
- c. relevant, consistent, and timely.
- d. complete, neutral, and free from material error.

Answer: d

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

36. Financial information that is provided to decision makers before it loses its capacity to influence their decisions is

- a. neutral.
- b. verifiable.
- c. timely.
- d. consistent.

Answer: c

Learning Objective: 01-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Fundamental concepts of financial reporting

[QUESTION]

37. Financial information which does **not** favor one set of interested parties over another is
- relevant.
 - verifiable.
 - neutral.
 - faithfully represented.

Answer: c

Learning Objective: 01-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Fundamental concepts of financial reporting

[QUESTION]

38. Employees demand financial information for all of the following **except**:
- Monitoring profit sharing and stock ownership plans.
 - Monitoring how much the senior executives earn.
 - Monitoring the health of company pension plans.
 - Monitoring union contracts that link negotiated wage increases to company financial performance.

Answer: b

Learning Objective: 01-02
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Remember
Topic: Financial statements—For decision-maker needs

[QUESTION]

39. Which of the following statements is correct with respect to economic incentives to release financial information?
- Because companies have an economic incentive to supply information investors want, regulatory groups have little influence over the amount and type of financial information that companies disclose.

- b. Because financial disclosures are regulated, owners and managers have little economic incentive to supply the amount and type of financial information that will enable them to raise capital most cheaply.
- c. Companies have an economic incentive to supply the information investors want in order to raise capital at the lowest possible cost.
- d. Owners and managers do not have an economic incentive to supply the amount and type of financial information because it has no effect on the company's ability to raise capital at the lowest cost.

Answer: c

Learning Objective: 01-01

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

Blooms: Understand

Topic: Financial statements—As sources of information

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

40. Which statement below describes efficient market investors?
- a. They presume they have no insight beyond the share price.
 - b. They believe that any new development is quickly and correctly reflected in the stock price.
 - c. They use financial statements to assess risk and dividend yields to make portfolio decisions.
 - d. All of these answer choices are correct.

Answer: d

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

41. Which of the following create a competitive disadvantage according to the full disclosure principle?
- a. Details about the company's strategies, plans and tactics.
 - b. Information about the company's technological and managerial innovations.
 - c. Detailed information about the company's operations.
 - d. All of these answer choices are correct.

Answer: d

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Understand

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

42. When independent measurers get similar results when using the same accounting measurement methods, the financial information is

- a. relevant.
- b. verifiable.
- c. timely.
- d. faithfully represented.

Answer: b

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

43. Being verifiable and neutral is part of what makes financial information

- a. useful.
- b. consistent.
- c. comparable.
- d. relevant.

Answer: a

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

44. If a company fails to disclose information about a lawsuit because it might be embarrassing to the company, it is violating

- a. relevance.
- b. verifiability.
- c. neutrality.
- d. timeliness.

Answer: c

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Topic: Fundamental concepts of financial reporting

[QUESTION]

45. Which of the following is **not** an accurate statement related to the demand for financial reporting?

- a. Economically realistic reporting standards are low when there are few important capital providers.
- b. Cross-country differences have no impact on capital funding opportunities and financial reporting practices.
- c. External investors who provide capital demand a reporting system that accurately depicts a company past economic performance and its future prospects.
- d. Comprehensive financial data is demanded when there is a broad base of external investors.

Answer: b

Learning Objective: 01-05

Difficulty: 2 Medium

AACSB: Diversity

AICPA: BB Global

AICPA: BB Resource Management

Blooms: Understand

Topic: Global differences and financial reporting

[QUESTION]

46. Financial information capable of making a difference in a decision is

- a. relevant.
- b. verifiable.
- c. consistent.
- d. neutral.

Answer: a

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

47. Business enterprises enter into many different types of contracts. Examples of such contracts that often contain language that refers to verifiable financial statement numbers include all of the following **except**

- a. royalty contracts with inventors.
- b. sales contracts with customers.
- c. compensation contracts with managers.
- d. debt contracts with bankers.

Answer: b

Learning Objective: 01-01

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Legal

AICPA: FN Measurement

Blooms: Understand

Topic: Financial statements—As sources of information

[QUESTION]

48. What type of trends and relationships can be gleaned from a company's financial statements?

- a. Rates of sales and accounts receivable growth.
- b. Rates of expense growth and expenses as a percentage of sales.
- c. How the company's growth rates compare to their competitors.
- d. All of these answer choices are correct.

Answer: d

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

49. The type of analysis that uses financial statements to assess a company's current market price is

- a. valuation analysis.
- b. efficient market analysis.
- c. fundamental analysis.
- d. technical analysis.

Answer: c

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

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Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

50. When financial statements are used by shareholders and investors to evaluate the performance of a company's top executives it is referred to as the _____ function of financial reports.

- a. proxy.
- b. fundamental.
- c. technical.
- d. stewardship.

Answer: d

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

51. Which statement is **not** true regarding the conservatism convention in accounting?

- a. Conservatism guides us to choose the approach that leads to lower assets or higher liabilities.
- b. Conservatism means we only record that of which we are 100% certain.
- c. Conservatism is sometimes used to defend poor accounting judgments.
- d. Conservatism strives to ensure that business risks and uncertainties are adequately reflected in the financial statements.

Answer: c

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Fundamental concepts of financial reporting

[QUESTION]

52. Investors who presume that they have no insights about company value beyond the current market price and use financial statement data to assess firm-specific attributes believe in the

- a. market-to-market hypothesis.
- b. efficient market hypothesis.
- c. fundamental market hypothesis.
- d. technical market hypothesis.

Answer: b

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—For decision-maker needs

[QUESTION]

53. Which of the following people outside the company do not demand financial statement information as a key input?

- a. Suppliers and Lenders.
- b. Government and Regulatory Agencies.
- c. Competitors.
- d. Customers.

Answer: c

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Industry

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

54. Which item below does **not** describe a politically vulnerable firm?

- a. The firm has contracts controlled by the government.
- b. The firm may face antitrust litigation or loss of protective import quotas.
- c. The firm is in a highly visible industry such as oil & gas or pharmaceuticals.
- d. The firm may be attacked in the financial and popular press for generating high earnings.

Answer: a

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Industry

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

55. Which of the following are **primary** qualitative characteristics of accounting information?

- a. Relevance and Timeliness.
- b. Relevance and Faithful Representation.
- c. Comparability and Timeliness.

d. Verifiability and Understandability.

Answer: b

Learning Objective: 01-01

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Financial statements—As sources of information

[QUESTION]

56. To achieve Faithful Representation, accounting information presented must meet which of the following requirements?

- a. It must be comparable so that analysts can use it.
- b. It must have predictive and confirmatory value.
- c. It must depict the underlying economic event, be complete, neutral, and free from material error.
- d. It must meet a materiality threshold.

Answer: c

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Fundamental concepts of financial reporting

[QUESTION]

57. The amounts of executive compensation and bonuses are often determined by

- a. auditor's recommendations.
- b. evaluations by subordinates.
- c. company compensation contracts.
- d. industry guidelines.

Answer: c

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

58. Whose responsibility is it to ensure that the company's financial information is properly assembled, classified, characterized, and presented clearly and concisely in order to make it understandable?

- a. The public accounting firm performing the audit.
- b. The SEC by enforcing reporting standards.
- c. Management of the company publishing the statements.
- d. FASB when drafting generally accepted accounting principles.

Answer: c

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

59. Which of the following is **not** an action taken by shareholders when the earnings and share price fall below acceptable levels?

- a. Letters to management and outside directors.
- b. Phone calls to management and outside directors.
- c. Launching a proxy contest.
- d. Filing a lawsuit for the lost value of the share price.

Answer: d

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

60. Employees demand financial statement information because the firm's performance is often linked to all of the following **except**

- a. negotiated wage increases in union contracts.
- b. social security benefits.
- c. pension plan benefits.
- d. employee profit sharing.

Answer: b

Learning Objective: 01-02

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

61. When a borrower violates a loan covenant that requires minimum achievement of an accounting measure in the financial statements, the lender can
- a. immediately seize the loan collateral.
 - b. fire the chief operating officer of the borrower.
 - c. report the borrower to the IRS.
 - d. call for immediate repayment of the loan.

Answer: d

Learning Objective: 01-02

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Resource Management

AICPA: FN Risk Analysis

Blooms: Remember

Topic: Financial statements—For decision-maker needs

[QUESTION]

62. Investors and analysts must have certain capabilities regarding financial reporting which include
- a. an understanding of current financial reporting standards.
 - b. recognition that management selects the financial reporting standards used.
 - c. an ability to recognize that financial statement information reported is grounded in judgment as well as facts.
 - d. all of these answer choices are correct.

Answer: d

Learning Objective: 01-01

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—As sources of information

[QUESTION]

63. The goal of generally accepted accounting principles is to ensure that a company's financial statements
- a. do not contain any representation that could jeopardize management.
 - b. provide stockholders all of the information they need to assess management's performance.
 - c. are accurate and free from fraud.
 - d. clearly represent its economic condition and performance of the company.

Answer: d

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Fundamental concepts of financial reporting

[QUESTION]

64. Timeliness is a qualitative characteristic of accounting information that indicates that information should be provided to users

- a. within one month after the close of the books.
- b. before it loses its capacity to influence their decisions.
- c. before statutory deadlines.
- d. every month.

Answer: b

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

65. Which one of the following types of disclosure costs is the cost of disclosing the company's pricing strategies?

- a. Political cost
- b. Litigation cost
- c. Competitive disadvantage cost
- d. Information collection, processing, and dissemination cost

Answer: c

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Understand

Financial statements—Disclosure costs and benefits

[QUESTION]

66. If the financial reporting environment were unregulated, disclosure would occur voluntarily

- a. as long as other companies in the reporting company's industry voluntarily disclosed financial information.

- b. only to analysts that the company believes will report favorably on the company's prospects.
- c. only when managers wanted to raise additional capital.
- d. as long as the incremental benefits to the company from supplying financial information exceeded the incremental costs of providing the information.

Answer: d

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

Blooms: Understand

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

67. Companies offering higher risk securities have incentives to mask their true condition by

- a. supplying overly optimistic financial information.
- b. not having their financial statements audited.
- c. listing on foreign exchanges where reporting requirements are less stringent than those in the U.S.
- d. including testimonials from well known executives in their financial statements.

Answer: a

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

68. One financial disclosure cost is the possibility that competitors may use the information to harm the company providing the disclosure. All of the following disclosures might create a competitive disadvantage **except**

- a. detailed information about company operations, such as sales and cost figures for individual product lines.
- b. information about the company's technological and managerial innovations.
- c. information showing the company's amount of spending on research and development.
- d. details about the company's strategies, plans and tactics.

Answer: c

Learning Objective: 01-03

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Understand

Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

69. It is common for shareholders to initiate litigation when

- a. the company reports record profits, but does not declare dividends.
- b. there is a sudden drop in stock price shortly after the company released new financial information.
- c. the company introduces new products that are found to be harmful to the environment.
- d. rumors about the company appear in the media that, if true, would result in slower growth in future profits.

Answer: b
Learning Objective: 01-03
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Understand
Topic: Financial statements—Disclosure costs and benefits

[QUESTION]

70. When comparing U.S. GAAP and IFRS standards, which of the following is **not** correct?
- a. IFRS is principles-based while U.S. GAAP is rules-based.
 - b. U.S. GAAP standards provide too many scope exceptions.
 - c. IFRS provides more detailed guidance than U.S. GAAP.
 - d. U.S. GAAP provides more detailed guidance than IFRS.

Answer: c
Learning Objective: 01-06
Difficulty: 2 Medium
AACSB: Diversity
AICPA: BB Global
AICPA: FN Measurement
Blooms: Understand
Topic: Standards differences—US GAAP and IFRS

[QUESTION]

71. Using the same accounting methods to record and report similar events from period to period demonstrates
- a. consistency.
 - b. comparability.
 - c. neutrality.
 - d. faithful representation.

Answer: a
Learning Objective: 01-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Fundamental concepts of financial reporting

[QUESTION]

72. Which one of the following has statutory authority to determine accounting rules for companies whose securities are owned by the general public?
- a. American Institute of Certified Public Accountants
 - b. State Boards of Accountancy

- c. Securities and Exchange Commission
- d. Financial Accounting Standards Board

Answer: c

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Remember

Topic: Standard-setting—US GAAP

[QUESTION]

73. Which of the following does **not** describe how FASB endeavors to draft pronouncements?

- a. Provide enough implementation guidance for consistent application.
- b. Explain the accounting principles being applied.
- c. Clearly define bright-line rules.
- d. Avoid bright line rules.

Answer: c

Learning Objective: 01-06

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Legal

AICPA: FN Measurement

Blooms: Understand

Topic: Standard-setting—US GAAP

[QUESTION]

74. The growth of global investing has spurred development of worldwide accounting standards that are written by the

- a. American Institute of Certified Public Accountants.
- b. Institute of Global Auditors.
- c. Global Committee on Accounting Standards.
- d. International Accounting Standards Board.

Answer: d

Learning Objective: 01-04

Learning Objective: 01-05

Difficulty: 1 Easy

AACSB: Diversity

AICPA: BB Global

Blooms: Remember

Topic: Standard-setting—IFRS

[QUESTION]

75. The organization responsible for establishing auditing standards and inspecting and investigating auditing practices of public accounting firms is

- a. Congress under the authority of the Sarbanes-Oxley Act (SOX).

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- b. the American Institute of Certified Public Accountants (AICPA).
- c. the Securities and Exchange Commission (SEC).
- d. the Public Company Accounting Oversight Board (PCAOB).

Answer: d

Learning Objective: 01-04

Learning Objective: 01-App1A

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: FN Measurement

AICPA: BB Legal

Blooms: Understand

Topic: Standard-setting—IFRS

Topic: Historical overview of US financial reporting

[QUESTION]

76. The only authoritative source of U.S. GAAP is created by FASB and exists in a single database known as

- a. the accounting standards database.
- b. FASB financial reporting standards.
- c. the converged accounting standards.
- d. the accounting standards codification.

Answer: d

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: FN Research

Blooms: Remember

Topic: Standard-setting—US GAAP

[QUESTION]

77. The ASC uses a structure in which the FASB's authoritative accounting guidance is organized into all of the following **except**

- a. chapters.
- b. topics.
- c. sections.
- d. paragraphs.

Answer: a

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: FN Research

Blooms: Remember

Topic: Standard-setting—US GAAP

[QUESTION]

78. ASC content is organized

- a. alphabetically by topic.
- b. in chronological order based on the issue date of the major pronouncement on which the content is based.
- c. without numerical reference to the original standard from which the content was derived.
- d. in the manner prescribed by the IASB.

Answer: c

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: FN Research

Blooms: Understand

Topic: Standard-setting—US GAAP

[QUESTION]

79. GAAP's flexibility in its reporting standards allows companies to

- a. smooth reported earnings over several reporting periods.
- b. change accounting estimates to meet target sales or earnings.
- c. change accounting principles to improve reported earnings.
- d. avoid adopting specific accounting techniques and reporting procedures.

Answer: a

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Management choices—Reporting strategies

[QUESTION]

80. Financial statements follow

- a. rigid guidelines that require specific adherence to regulated procedures.
- b. generally accepted guidelines that allow management a degree of flexibility in choices
- c. general guidelines with little choice among different procedures.
- d. legal requirements for uniform presentation and disclosure.

Answer: b

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Management choices—Reporting strategies

[QUESTION]

81. A company manages a large portfolio of marketable securities and sells only stocks with substantial gains in poor income years or sells only stocks with substantial losses in good income years. This strategy is an indication of

- a. securities fraud.
- b. unstable portfolio management.
- c. income smoothing.
- d. violating security trading laws.

Answer: c

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Analyze

Topic: Management choices—Reporting strategies

[QUESTION]

82. Identify the correct order of the three steps constituting the FASB's "due process" procedure.

- a. Public-hearing stage, exposure-draft stage, and voting stage.
- b. Discussion-memorandum stage, public-hearing stage, and voting stage.
- c. Exposure-draft stage, discussion-memorandum stage, and voting stage.
- d. Discussion-memorandum stage, exposure-draft stage, and voting stage.

Answer: d

Learning Objective: 01-App1A

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Understand

Topic: Historical overview of US financial reporting

[QUESTION]

83. The Securities and Exchange Act of 1934 required all publicly traded firms to

- a. purchase insurance against corporate bankruptcy.
- b. register with an authorized stock exchange.
- c. provide annual financial statements audited by independent accountants.
- d. file balance sheets, income statements, and statements of cash flow with the SEC each year.

Answer: c

Learning Objective: 01-App1A

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Remember

Topic: Historical overview of US financial reporting

[QUESTION]

84. The Financial Accounting Standards Board has responsibility for the establishment of U. S. accounting standards and

- a. full statutory power to enforce compliance with GAAP.
- b. authority from the SEC to enforce compliance with GAAP.
- c. no authority or responsibility to enforce compliance with GAAP.
- d. responsibility imposed by AICPA to enforce compliance with GAAP.

Answer: c

Learning Objective: 01-App1A

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Understand

Topic: Historical overview of US financial reporting

[QUESTION]

85. When financial information is measured and reported in a similar manner across different companies in the same industry it is

- a. consistent.
- b. comparable.
- c. neutral.
- d. faithfully represented.

Answer: b

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

86. When a company changes from straight-line to the declining balance method of accounting for depreciation, the financial statements lack

- a. comparability.
- b. consistency.
- c. neutrality.
- d. faithful representation.

Answer: b

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Fundamental concepts of financial reporting

[QUESTION]

87. The network of conventions, rules, guidelines, and procedures used by the accounting profession is known as generally accepted

- a. auditing standards.
- b. accounting procedures.
- c. accounting principles.
- d. auditing principles.

Answer: c

Learning Objective: 01-04

Difficulty: 1 Easy

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Topic: Fundamental concepts of financial reporting

[QUESTION]

88. Omissions or misstatements within a financial statement which could influence the decisions of the user of the statement violates

- a. neutrality.
- b. consistency.
- c. conservatism.
- d. materiality.

Answer: d

Learning Objective: 01-04

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Fundamental concepts of financial reporting

[QUESTION]

89. Some countries' philosophy of financial reporting differs from U.S. GAAP because their financial reports are required to

- a. be verifiable.
- b. conform to tax and/or commercial law.
- c. be reported and measured in a similar manner across companies.
- d. use the same accounting methods for similar events period to period.

Answer: b

Learning Objective: 01-05

Difficulty: 2 Medium

AACSB: Diversity

AACSB: Reflective Thinking

AICPA: BB Legal

AICPA: BB Global

Blooms: Understand

Topic: Global differences and financial reporting

[QUESTION]

90. Differences between IFRS and U.S. GAAP include all of the following **except**

- a. Reversal of inventory write-downs.
- b. Carrying value of investment property.
- c. Revenue recognition.
- d. Research and development costs.

Answer: c

Learning Objective: 01-06

Difficulty: 2 Medium

AACSB: Reflective Thinking

AACSB: Diversity

AICPA: BB Global

AICPA: FN Measurement

Blooms: Understand

Topic: Standards differences—US GAAP and IFRS

[QUESTION]

91. Financial reporting philosophies differ across countries. These philosophies evolve from and reflect several factors including all of the following **except**

- a. the language(s) spoken in the country.
- b. the specific political institutions within the country.
- c. the specific financial institutions within the country.
- d. the country's social customs.

Answer: a

Learning Objective: 01-05

Difficulty: 2 Medium

AACSB: Reflective Thinking

AACSB: Diversity

AICPA: BB Global

Blooms: Understand

Topic: Global differences and financial reporting

[QUESTION]

92. Companies needing to access new and ever larger sources of capital in response to increased international competitiveness face a severe disadvantage if their financial reporting

- a. is in accordance with IFRS.
- b. is in accordance with U.S. GAAP.
- c. is based on a commercial and tax law approach.
- d. is based on an economic performance approach.

Answer: c

Learning Objective: 01-05

Difficulty: 2 Medium

AACSB: Reflective Thinking

AACSB: Diversity

AICPA: BB Global
AICPA: BB Resource Management
Blooms: Understand
Topic: Global differences and financial reporting

[QUESTION]

93. International financial reporting standards are currently established by the
- a. IASC.
 - b. IASB.
 - c. FASB.
 - d. PCAOB.

Answer: b
Learning Objective: 01-04
Learning Objective: 01-06
Difficulty: 1 Easy
AACSB: Reflective Thinking
AACSB: Diversity
AICPA: BB Global
Blooms: Remember
Topic: Standard-setting—IFRS
Topic: Standards differences—US GAAP and IFRS

[QUESTION]

94. IFRS frequently
- a. are automatically approved for any foreign listed company, as soon as a new standard is issued.
 - b. permit only one accounting treatment for similar business transactions and events to promote comparability.
 - c. allow firms less latitude when compared to U.S. GAAP.
 - d. follow a more generalized overview approach than do U.S. GAAP counterpart standards.

Answer: d
Learning Objective: 01-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AACSB: Diversity
AICPA: BB Global
Blooms: Understand
Topic: Standards differences—US GAAP and IFRS

[QUESTION]

95. International Financial Reporting Standards (IFRS) are
- a. built on broad principles.
 - b. rules-based.
 - c. narrowly defined, detailed standards.
 - d. seldom different than those issued by the FASB.

Answer: a

Learning Objective: 01-06

Difficulty: 1 Easy

AACSB: Reflective Thinking

AACSB: Diversity

AICPA: Global

Blooms: Remember

Topic: Standards differences—US GAAP and IFRS

[QUESTION]

96. Which of the following statements regarding IFRS is **incorrect**?

- a. All companies listed on the London Stock Exchange must use IFRS.
- b. The SEC-required Form 20-F must be filed with the SEC by foreign issuers within 30 days.
- c. The European Commission must “endorse” IFRS for required use by EU companies.
- d. The SEC has expressed concern that transitioning to IFRS might be prohibitively expensive and might lessen U.S. influence over standard setting.

Answer: b

Learning Objective: 01-06

Difficulty: 2 Medium

AACSB: Reflective Thinking

AACSB: Diversity

AICPA: BB Legal

AICPA: BB Global

Blooms: Understand

Topic: Standards differences—US GAAP and IFRS

[QUESTION]

97. Accounting information is heavily regulated

- a. To increase reporting efficiency.
- b. With the intention of preventing market failure.
- c. To prevent abuse given that the incentives of information producers are not necessarily aligned with those of users.
- d. All of these answer choices are correct.

Answer: d

Learning Objective: 01-App1A

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Legal

Blooms: Understand

Topic: Historical overview of US financial reporting

[QUESTION]

98. When is it permissible to issue financial statements that contain a material departure from GAAP?

- a. It is never permitted.
- b. When it is a non-US corporation.

- c. When the auditor can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading.
- d. When management does not like the GAAP results.

Answer: c

Learning Objective: 01-App1A

Difficulty: 2 Medium

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Topic: Historical overview of US financial reporting