

# CHAPTER 1

## FINANCIAL ACCOUNTING AND ACCOUNTING STANDARDS

### MULTIPLE CHOICE—Conceptual

Answer	No.	Description
d	1.	Users of financial reports.
d	2.	Identify the major financial statements.
a	3.	Financial reporting entity.
d	4.	Efficient use of resources.
d	5.	Capital allocation process.
c	6.	Financial statement information.
c	7.	Objectives of financial reporting.
b	8.	Common set of standards and procedures.
c	9.	Role of SEC.
c	10.	Powers of the SEC.
d	11.	SEC enforcement.
d	12.	Creation of FASB.
d	13.	Appointment of FASB members.
a	14.	Purpose of the Financial Accounting Foundation.
b	15.	Characteristics of FASB.
b	16.	FASB and "due process" system.
b	17.	Publications of FASB.
c	18.	Purpose of FASB Technical Bulletins.
d	19.	Purpose of Emerging Issues Task Force.
b	20.	Purpose of GASB.
c	21.	Domain of GASB.
c	22.	Standard setting organizations.
d	23.	Identification of standard setting organizations.
d	24.	Nature of GAAP.
d	25.	Body which promulgates GAAP.
d	26.	Authoritative category of GAAP.
d	27.	Publications which are not GAAP.
d	28.	Publications which are not GAAP.
a	29.	Political environment of standard setting.
c	30.	International Accounting Standards Committee.

### EXERCISES

Item	Description
E1-31	Objectives of financial reporting.
E1-32	Publications and organizations.
E1-33	FASB.
E1-34	Evolution of a statement of financial accounting standards.
E1-35	Development of accounting principles.

## CHAPTER LEARNING OBJECTIVES

1. Identify the major financial statements and other means of financial reporting.
2. Explain how accounting assists in the efficient use of scarce resources.
3. Identify some of the challenges facing accounting.
4. Identify the objectives of financial reporting.
5. Explain the need for accounting standards.
6. Identify the major policy-setting bodies and their role in the standards-setting process.
7. Explain the meaning of generally accepted accounting principles.
8. Describe the impact of user groups on the standards-setting process.
9. Understand issues related to ethics and financial accounting.

## SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	MC	2.	MC	3.	MC								
Learning Objective 2													
4.	MC	5.	MC										
Learning Objective 3													
6.	MC												
Learning Objective 4													
7.	MC	31.	E										
Learning Objective 5													
8.	MC	35.	E										
Learning Objective 6													
9.	MC	12.	MC	15.	MC	18.	MC	21.	MC	32.	E	35.	E
10.	MC	13.	MC	16.	MC	19.	MC	22.	MC	33.	E		
11.	MC	14.	MC	17.	MC	20.	MC	23.	MC	34.	E		
Learning Objective 7													
24.	MC	25.	MC	26.	MC	27.	MC	28.	MC				
Learning Objective 8													
29.	MC	30.	MC	35.	E								

Note: MC = Multiple Choice  
E = Exercise

**MULTIPLE CHOICE—Conceptual**

1. Users of financial reports include all of the following *except*
  - a. creditors.
  - b. government agencies.
  - c. unions.
  - d. All of these are users.
2. The financial statements most frequently provided include all of the following *except* the
  - a. balance sheet.
  - b. income statement.
  - c. statement of cash flows.
  - d. statement of retained earnings.
3. The information provided by financial reporting pertains to
  - a. individual business enterprises, rather than to industries or an economy as a whole or to members of society as consumers.
  - b. business industries, rather than to individual enterprises or an economy as a whole or to members of society as consumers.
  - c. individual business enterprises, industries, and an economy as a whole, rather than to members of society as consumers.
  - d. an economy as a whole and to members of society as consumers, rather than to individual enterprises or industries.
4. Whether a business is successful and thrives is determined by
  - a. markets.
  - b. free enterprise.
  - c. competition.
  - d. all of these.
5. An effective capital allocation process
  - a. promotes productivity.
  - b. encourages innovation.
  - c. provides an efficient market for buying and selling securities.
  - d. all of these.
6. Financial statements in the early 2000s provide information related to
  - a. non-financial measurements.
  - b. forward-looking data.
  - c. hard assets (inventory and plant assets).
  - d. none of these.
7. Which of the following statements is *not* an objective of financial reporting?
  - a. Provide information that is useful in investment and credit decisions.
  - b. Provide information about enterprise resources, claims to those resources, and changes to them.
  - c. Provide information on the liquidation value of an enterprise.
  - d. Provide information that is useful in assessing cash flow prospects.

8. A common set of accounting standards and procedures are called
  - a. financial accounting standards.
  - b. generally accepted accounting principles.
  - c. objectives of financial reporting.
  - d. statements of financial accounting concepts.
9. The role of the Securities and Exchange Commission in the formulation of accounting principles can be best described as
  - a. consistently primary.
  - b. consistently secondary.
  - c. sometimes primary and sometimes secondary.
  - d. non-existent.
10. The body that has the power to prescribe the accounting practices and standards to be employed by companies that fall under its jurisdiction is the
  - a. FASB.
  - b. AICPA.
  - c. SEC.
  - d. APB.
11. Companies that are listed on a stock exchange are required to submit their financial statements to the
  - a. AICPA.
  - b. APB.
  - c. FASB.
  - d. SEC.
12. The Financial Accounting Standards Board (FASB) was proposed by the
  - a. American Institute of Certified Public Accountants.
  - b. Accounting Principles Board.
  - c. Study Group on the Objectives of Financial Statements.
  - d. Special Study Group on establishment of Accounting Principles (Wheat Committee).
13. The Financial Accounting Standards Board
  - a. has issued a series of pronouncements entitled Statements on Auditing Standards.
  - b. was the forerunner of the current Accounting Principles Board.
  - c. is the arm of the Securities and Exchange Commission responsible for setting financial accounting standards.
  - d. is appointed by the Financial Accounting Foundation.
14. The Financial Accounting Foundation
  - a. oversees the operations of the FASB.
  - b. oversees the operations of the AICPA.
  - c. provides information to interested parties on financial reporting issues.
  - d. works with the Financial Accounting Standards Advisory Council to provide information to interested parties on financial reporting issues.

15. The major distinction between the Financial Accounting Standards Board (FASB) and its predecessor, the Accounting Principles Board (APB), is
  - a. the FASB issues exposure drafts of proposed standards.
  - b. all members of the FASB are fully remunerated, serve full time, and are independent of any companies or institutions.
  - c. all members of the FASB possess extensive experience in financial reporting.
  - d. a majority of the members of the FASB are CPAs drawn from public practice.
16. The Financial Accounting Standards Board employs a "due process" system which
  - a. is an efficient system for collecting dues from members.
  - b. enables interested parties to express their views on issues under consideration.
  - c. identifies the accounting issues that are the most important.
  - d. requires that all accountants must receive a copy of financial standards.
17. Which of the following is *not* a publication of the FASB?
  - a. Statements of Financial Accounting Concepts
  - b. Accounting Research Bulletins
  - c. Interpretations
  - d. Technical Bulletins
18. FASB Technical Bulletins
  - a. are similar to FASB Interpretations in that they establish enforceable standards under the AICPA's Code of Professional Ethics.
  - b. are issued monthly by the FASB to deal with current topics.
  - c. are not expected to have a significant impact on financial reporting in general and provide guidance when it does not conflict with any broad fundamental accounting principle.
  - d. were recently discontinued by the FASB because they dealt with specialized topics having little impact on financial reporting in general.
19. The purpose of the Emerging Issues Task Force is to
  - a. develop a conceptual framework as a frame of reference for the solution of future problems.
  - b. lobby the FASB on issues that affect a particular industry.
  - c. do research on issues that relate to long-term accounting problems.
  - d. issue statements which reflect a consensus on how to account for new and unusual financial transactions that need to be resolved quickly.
20. The Governmental Accounting Standards Board
  - a. oversees the activities of the SEC.
  - b. is a private-sector body, which addresses state and local governmental reporting issues.
  - c. is a division of the Securities and Exchange Commission, which oversees the corporate accounting in annual reports.
  - d. was terminated when the Financial Accounting Standards Board was created.
21. The Governmental Accounting Standards Board's main purpose is to develop standards for
  - a. the General Accounting Office.
  - b. the Federal government.
  - c. state and local government.
  - d. the Internal Revenue Service.

22. Which of the following organizations has *not* been instrumental in the development of financial accounting standards in the United States?
- AICPA
  - FASB
  - IASB
  - SEC
23. An organization that has *not* published accounting standards is the
- American Institute of Certified Public Accountants.
  - Securities and Exchange Commission.
  - Financial Accounting Standards Board.
  - All of these have published accounting standards.
24. Generally accepted accounting principles
- include detailed practices and procedures as well as broad guidelines of general application.
  - are influenced by pronouncements of the SEC and IRS.
  - change over time as the nature of the business environment changes.
  - all of these.
25. The most significant current source of generally accepted accounting principles is the
- AICPA.
  - SEC.
  - APB.
  - FASB.
26. The most authoritative category of generally accepted accounting principles includes all of the following *except*
- Accounting Research Bulletins.
  - APB Opinions.
  - FASB Standards.
  - FASB Technical Bulletins.
27. Which of the following is *not* a part of generally accepted accounting principles?
- FASB Interpretations
  - CAP Accounting Research Bulletins
  - APB Opinions
  - All of these are part of generally accepted accounting principles.
28. Which of the following publications does *not* qualify as a statement of generally accepted accounting principles?
- Statements of financial standards issued by the FASB
  - Accounting interpretations issued by the FASB
  - APB Opinions
  - Accounting research studies issued by the AICPA
29. Financial accounting standard-setting in the United States
- can be described as a social process which reflects political actions of various interested user groups as well as a product of research and logic.
  - is based solely on research and empirical findings.
  - is a legalistic process based on rules promulgated by governmental agencies.
  - is democratic in the sense that a majority of accountants must agree with a standard before it becomes enforceable.

30. The purpose of the International Accounting Standards Board is to
- issue enforceable standards which regulate the financial accounting and reporting of multinational corporations.
  - develop a uniform currency in which the financial transactions of companies throughout the world would be measured.
  - promote uniform accounting standards among countries of the world.
  - arbitrate accounting disputes between auditors and international companies.

### Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	d	6.	c	11.	d	16.	b	21.	c	26.	d
2.	d	7.	c	12.	d	17.	b	22.	c	27.	d
3.	a	8.	b	13.	d	18.	c	23.	d	28.	d
4.	d	9.	c	14.	a	19.	d	24.	d	29.	a
5.	d	10.	c	15.	b	20.	b	25.	d	30.	c

## EXERCISES

**Ex. 1-31**—Objectives of financial reporting.

What are the objectives of financial reporting by business enterprises?

### Solution 1-31

The objectives of financial reporting are to provide information:

- that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.
- to help users in assessing the amounts, timing, and uncertainty of prospective cash flows.
- clearly portraying the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change its resources and obligations.

**Ex. 1-32**—Publications and organizations.

Significant accounting publications are listed below (1-9). Sources or sponsors of accounting publications are identified next by alphabetical character (a-f). Match the publications with their sources.

Publications

- \_\_\_\_\_ 1. Accounting Research Bulletins (1953-1959)
- \_\_\_\_\_ 2. Statements on Auditing Standards
- \_\_\_\_\_ 3. Journal of Accountancy
- \_\_\_\_\_ 4. Emerging Issues Task Force Statements
- \_\_\_\_\_ 5. Opinions (1962-1973)
- \_\_\_\_\_ 6. Technical Bulletins
- \_\_\_\_\_ 7. Statements of Financial Accounting Standards
- \_\_\_\_\_ 8. Statements of Financial Accounting Concepts
- \_\_\_\_\_ 9. Statements of Position (SOPs)

Sources/Sponsors

- |   |   |
|---|---|
| a. Auditing Standards Board                 | d. Committee on Accounting Procedure    |
| b. Accounting Standards Executive Committee | e. Accounting Principles Board          |
| c. The AICPA                                | f. Financial Accounting Standards Board |

**Solution 1-32**

- |      |      |      |
|------|------|------|
| 1. d | 4. f | 7. f |
| 2. a | 5. e | 8. f |
| 3. c | 6. f | 9. b |

**Ex. 1-33**—FASB.

The Financial Accounting Standards Board was established because many groups interested in financial reporting believed that the Accounting Principles Board was not effective. Discuss the apparent advantages that the FASB should have over its earlier counterpart, the APB.

**Solution 1-33**

- 1. Smaller membership. The FASB is composed of seven members, replacing the relatively large 18-member APB.
- 2. Full-time, remunerated membership. FASB members are well-paid, full-time members, appointed for renewable five-year terms. The APB members were unpaid and part-time.



**Solution 1-33** (cont.)

3. Greater autonomy. The APB was a senior committee of the AICPA, whereas the FASB is not an organ of any single professional organization. It is appointed by and answerable only to the Financial Accounting Foundation.
4. Increased independence. APB members retained their private positions with firms, companies, or institutions. FASB members must sever all such ties.
5. Broader representation. All APB members were required to be CPAs and members of the AICPA. Currently, it is not necessary to be a CPA to be a member of the FASB.

**Ex. 1-34**—Evolution of a statement of financial accounting standards.

In establishing financial accounting standards, two basic premises of the FASB are (1) The FASB should be responsive to the needs and viewpoints of the entire economic community, not just the accounting profession. (2) It should operate in full view of the public through a "due process" system that gives interested persons ample opportunity to make their views known. To ensure achievement of these goals, what are the steps taken in the evolution of an FASB Statement of Financial Accounting Standards?

**Solution 1-34**

The steps in the evolution of an FASB Statement of Financial Accounting Standards are:

- a. Topics are identified and placed on the Board's agenda.
- b. Research and analysis are conducted and a discussion memorandum of pros and cons is issued.
- c. A public hearing on the proposed standard is held.
- d. The Board evaluates the research and public response and issues an exposure draft.
- e. The Board evaluates the responses and changes the exposure draft, if necessary. The final standard is then issued.

**Ex. 1-35**—Development of accounting principles.

Presented below are four independent, unrelated statements regarding the formulation of generally accepted accounting principles. Each statement contains some incorrect or debatable statement(s).

Statement I

The users of financial accounting statements have coinciding and conflicting needs for statements of various types. To meet these needs, and to satisfy the financial reporting responsibility of management, accountants prepare different sets of financial statements for different users.

Statement II

The FASB should be responsive to the needs and viewpoints of the entire economic community, not just the public accounting profession. The FASB therefore will succeed because it will deal effectively with all interested groups.

**Ex. 1-35** (cont.)

Statement III

Due to some well-publicized instances of corporate fraud, domestic and foreign bribery, and sudden bankruptcies, the Congress of the United States began in the mid-seventies to inquire into the structure and practices of the accounting profession and the accounting and auditing standard-setting process. As a consequence of these investigations and reports submitted by the committees, the government has now (1) assumed full responsibility through the Securities and Exchange Commission (SEC) for the development and enforcement of financial accounting and reporting standards and (2) assumed full responsibility through the General Accounting Office (GAO) for the development and enforcement of auditing standards.

Statement IV

The Securities and Exchange Commission is very concerned about financial reporting and has formulated a committee called the Accounting Standards Executive Committee (AcSEC) to provide input to the FASB. In addition, after each FASB Statement is issued, the AcSEC issues Statements of Position stating its position on the FASB statement.

**Instructions**

Evaluate each of the independent statements and identify the areas of fallacious reasoning in each. Explain why the reasoning is incorrect. Complete your discussion of each statement before proceeding to the next statement.

**Solution 1-35**

Statement I

It is true that users of financial accounting statements have coinciding and conflicting needs for statements of various types. However, to meet these needs, accountants generally prepare a single set of general-purpose financial statements, rather than a number of different types of financial statements. It may be argued that accountants often do prepare special statements for particular purposes, but in general the accounting profession has relied on general purpose financial statements prepared in conformance with generally accepted accounting principles.

Statement II

It is true that the FASB should be responsive to the needs of the entire economic community, not just the public accounting profession. However, it is not clear whether the FASB will succeed. The FASB will have the best chance of survival if it deals with problems promptly, sets proper priorities, takes whatever action it thinks is right and in the public interest, and handles pressures responsibly without overreacting to them.

Statement III

The first sentence of Statement III is correct in that during the mid-seventies Congress, through the Moss and Metcalf Committees, did make inquiries into the accounting profession's practices and the accounting and auditing standard-setting process. In fact, the reports submitted by these committees contained some incorrect conclusions and some very strong remedies, but the government has not assumed responsibility for either accounting or auditing standard-setting or their enforcement. Instead, the accounting profession has taken significant steps to overcome the

**Solution 1-35 (cont.)**

criticisms which emanated from the congressional inquiries and has retained in the private sector both the accounting and auditing standards-setting functions. At the present time the government appears willing to permit the accounting profession to develop its own standards and to regulate itself with minimal intervention. The AICPA formed the Special Committee on Financial Reporting in 1991. The Committee's charge was to recommend (1) the nature of information that should be made available to others by management and (2) the extent to which auditors should report on the various elements of that information. The Committee's report was made in October 1994.

Statement IV

The Accounting Standards Executive Committee (AcSEC) was established within the American Institute of Certified Public Accountants, not the Securities and Exchange Commission, to respond to pronouncements of the FASB. The AcSEC does issue Statements of Position, but issues them before the FASB sets standards on the issue.