

True-False

1. The best source of information about a company's current health and prospects for the future is the company's financial statements.
2. All financial statements provide a basis for what will occur in the future.
3. Investors use financial statements as an analytical tool.
4. Financial statements follow rigid guidelines that require adherence to specific procedures.
5. The type of analysis that uses financial statements along with industry and macroeconomic data to forecast future stock movements is technical analysis.
6. The school of stock market analysis known as *technical* analysis relies on financial statement information.
7. Suppliers monitor the financial statements of their customers to protect collection of their accounts receivable.
8. Sales value of assets minus liabilities owed is a company's liquidation value.
9. The ability to raise additional cash by selling assets, issuing stock, or borrowing more is financial flexibility.
10. All of the information needed by professional analysts to give a complete picture of a company is found in the published financial statements.
11. The network of conventions, rules, guidelines, and procedures used by the accounting profession is known as generally accepted auditing standards.
12. Some countries' philosophy of financial reporting differs from GAAP because their financial reports are required to conform to tax law.
13. Financial information capable of making a difference in a decision is relevant.
14. Timeliness is a qualitative characteristic of accounting information that indicates that information should be provided to users before statutory deadlines.
15. The degree to which the accounting actually represents the underlying economic events is representational faithfulness.
16. Using the same accounting methods to record and report similar events from period to period demonstrates comparability.
17. The convention in accounting that strives to ensure business risks and uncertainties are adequately reflected in the financial statements is conservatism.
18. Generally accepted accounting principles are set by the Securities and Exchange Commission.
19. The Financial Accounting Standards Board has the sole responsibility for setting generally accepted auditing standards.
20. The Financial Accounting Standards Board has responsibility for the establishment of U. S. accounting standards.

Multiple-Choice Questions

Select the best answer from those provided.

21. 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.
22. All financial statements provide a basis for:
 - a. what will occur in the future.
 - b. changes that take place over time.
 - c. evaluating what happened in the past.
 - d. a picture of the company at a point in time.
23. 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 of its common and preferred stock.
24. Financial statements follow
 - a. rigid guidelines that require specific adherence to regulated procedures.
 - b. generally accepted guidelines that allow management to choose among different procedures.
 - c. general guidelines with little choice among different procedures.
 - d. legal requirements for uniform presentation and disclosure.
25. The market analysis known as *fundamental* analysis
 - a. predicts future trends in the financial drivers of a company's success or failure.
 - b. relies on price and volume movement of stock.
 - c. have no insights about company value beyond current market price.
 - d. uses microeconomic data to forecast stock values.
26. The type of analysis that uses financial statements along with industry and macroeconomic data to forecast future stock movements is

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

27. The type of analysis that does **not** concern itself with financial statement numbers is

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

28. 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 variables believe in the

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

29. The school of stock market analysis known as *technical* analysis relies on

- a. price and volume movement of stocks.
- b. balance sheet information.
- c. financial statement ratio analysis.
- d. income statement numbers.

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

- a. auditor's recommendations.
- b. evaluations by subordinates.
- c. financial statements.
- d. industry guidelines.

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

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

32. 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 the loan for immediate repayment.

33. 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

34. 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.

35. 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.

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

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

37. 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.

- 38.** Professional analysts need information to predict 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.
- 39.** Published reports of public companies include a description of the company's business risks, results of operations, financial condition, and future plans for the company known as the
- management discussion and analysis.
 - management representation letter.
 - President's message.
 - Board of Directors' analysis.
- 40.** The network of conventions, rules, guidelines, and procedures used by the accounting profession is known as generally accepted
- auditing standards.
 - accounting procedures.
 - accounting principles.
 - auditing principles.
- 41.** GAAP's goals are to ensure that financial statements
- do not contain any representation that could jeopardize management.
 - provide stockholders all of the information they need to assess management's performance.
 - are accurate and free from fraud.
 - clearly reflect the economic condition and performance of the company.
- 42.** Some countries' philosophy of financial reporting differs from GAAP because their financial reports are required to
- be verifiable.
 - conform to tax and/or commercial law.
 - be reported and measured in a similar manner across companies.
 - use the same accounting methods for similar events period to period.
- 43.** Financial information capable of making a difference in a decision is
- relevant.
 - verifiable.
 - consistent.
 - neutral.
- 44.** Relevant financial information
- is free from bias and error.
 - is measured in a similar manner among different companies.
 - can be independently verified.
 - is capable of making a difference in a decision.
- 45.** Financial information that is provided to decision makers before it loses its capacity to influence their decisions is
- neutral.
 - verifiable.
 - timely.
 - consistent.
- 46.** Timeliness is a qualitative characteristic of accounting information that indicates that information should be provided to users
- within one month after the close of the books.
 - before it loses its capacity to influence their decisions.
 - before statutory deadlines.
 - every month.
- 47.** Reliable information is
- consistent, unbiased, and relevant.
 - relevant, comparable, and timely.
 - relevant, consistent, and timely.
 - factual, truthful, and unbiased.
- 48.** Financial information that is verifiable, faithfully represented, and neutral is
- reliable.
 - consistent.
 - comparable.
 - relevant.
- 49.** When independent measurers get similar results when using the same accounting measurement methods, the financial information is
- relevant.
 - verifiable.
 - timely.
 - faithfully represented.

- 50.** Financial information that does **not** favor one set of interested parties over another is
- relevant.
 - verifiable.
 - neutral.
 - faithfully represented.
- 51.** If a company fails to disclose information about a lawsuit because it might be embarrassing to the company, it is violating
- relevance.
 - verifiability.
 - neutrality.
 - timeliness.
- 52.** When financial information is measured and reported in a similar manner across different companies in the same industry it is
- consistent.
 - comparable.
 - neutral.
 - faithfully represented.
- 53.** Using the same accounting methods to record and report similar events from period to period demonstrates
- consistency.
 - comparability.
 - neutrality.
 - faithful representation.
- 54.** When a company changes from straight-line to the declining balance method of accounting for depreciation, it violates
- comparability.
 - consistency.
 - neutrality.
 - faithful representation.
- 55.** When a financial statement contains omissions or misstatements that would alter the judgment of a reasonable person, it violates
- neutrality.
 - consistency.
 - conservatism.
 - materiality.
- 56.** Which one of the following has statutory authority to determine accounting rules?
- American Institute of Certified Public Accountants
 - State Boards of Accountancy
 - Securities and Exchange Commission
 - Financial Accounting Standards Board
- 57.** The growth of global investing has spurred development of worldwide accounting standards that are written by the
- American Institute of Certified Public Accountants.
 - Institute of Global Auditors.
 - Global Committee on Accounting Standards.
 - International Accounting Standards Board.
- 58.** GAAP's flexibility in its reporting standards allows companies to
- smooth reported earnings over a several reporting periods.
 - change accounting estimates to meet target sales or earnings.
 - change accounting principles to improve reported earnings.
 - adopt specific accounting techniques and reporting procedures.
- 59.** If 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, the company is guilty of
- nothing.
 - wise portfolio management.
 - income smoothing.
 - violating security trading laws.
- 60.** The Securities and Exchange Act of 1934 required all publicly traded firms to
- purchase insurance against corporate bankruptcy.
 - register with an authorized stock exchange.
 - provide annual financial statements audited by independent accountants.
 - file balance sheets, income statements, and statements of cash flow with the SEC each year.
- 61.** The primary mission of the Committee on Accounting Procedures was to
- establish accounting standards.
 - develop and enforce accounting standards.

- c. develop a statement of accounting concepts and solve current accounting controversies.
- d. establish, review, and evaluate accepted accounting procedures.
- 62.** In 1973 the pronouncements of the Financial Accounting Standards Board were formally acknowledged as having “substantial authoritative support” by the
- American Institute of Certified Public Accountants.
 - Securities and Exchange Commission.
 - United States Congress.
 - National Association of State Boards of Accountancy.
- 63.** The Financial Accounting Standards Board has responsibility for the establishment of U. S. accounting standards and
- full statutory power to enforce compliance with GAAP.
 - authority from the SEC to enforce compliance with GAAP.
 - no authority or responsibility to enforce compliance with GAAP.
 - responsibility imposed by AICPA to enforce compliance with GAAP.
- 64.** Which one of the following includes the three steps of the due process procedures of the FASB?
- Public-hearing stage, exposure-draft stage, and voting stage
 - Discussion-memorandum stage, public-hearing stage, and voting stage
 - Exposure-draft stage, discussion-memorandum stage, and voting stage
 - Discussion-memorandum stage, exposure-draft stage, and voting stage

Essay and Computational Questions

- 65.** Stock markets are common in many countries and economies. Explain the need for and use of a stock market in an economy.
- Suggested Answer:** Enable an efficient allocation of capital. Market Place for buyers and sellers to meet. Provide Liquidity.
- 66.** A tremendous amount of time, money, and effort are spent on the compilation of quarterly and yearly Financial Reports. Correspondingly, they attract a lot of attention and scrutiny. Explain what is the roll and importance of financial reports in capital markets.
- Suggested Answer:** Provide relevant information on companies’ financial condition and performance to current and potential stakeholders. Facilitate efficient decision making.

67. Financial reporting is arguably one of the most heavily regulated areas of business activity. Provide the main reasons why accounting information is so heavily regulated. In your answer try to address the intended consequences of such regulation.

Suggested Answer: Increase efficiency. Prevent market failure. Prevent Abuse. Incentives of information producers are not aligned with those of users. Reliability. Comparability.

68. Who may benefit from accounting regulation? In your answer try to include anyone in the economy who is affected and explain what the direct or indirect impact may be.

Suggested Answer: Everyone—if the regulation improves asset allocation, the entire economy may be better off. Current Investors/Potential Investors—if companies are now more comparable and/or more transparent. Lenders/Potential Lenders—if they can assess risk better.

Answers

- E; True
- M; False
- E; True
- M; False
- M; False
- M; False
- M; True
- E; True
- M; True
- M; False
- E; False
- M; True
- E; True
- M; False
- M; True
- E; False
- M; True
- E; False
- M; False

- 20. M; True
- 21. M; (d)
- 22. M; (c)
- 23. M; (c)
- 24. M; (b)
- 25. D; (a)
- 26. M; (c)
- 27. M; (d)
- 28. M; (b)
- 29. M; (a)
- 30. M; (c)
- 31. M; (b)
- 32. M; (d)
- 33. E; (c)
- 34. M; (c)
- 35. M; (d)
- 36. M; (b)
- 37. M; (a)
- 38. M; (d)
- 39. M; (a)
- 40. E; (c)
- 41. M; (d)
- 42. D; (b)
- 43. E; (a)
- 44. M; (d)
- 45. E; (c)
- 46. M; (b)
- 47. E; (d)
- 48. M; (a)
- 49. M; (b)
- 50. M; (c)
- 51. M; (c)
- 52. E; (b)
- 53. E; (a)
- 54. M; (b)
- 55. E; (d)
- 56. E; (c)
- 57. M; (d)
- 58. E; (d)
- 59. M; (c)
- 60. M; (c)
- 61. D; (d)
- 62. M; (b)
- 63. M; (c)
- 64. M; (d)