CHAPTER 1

FINANCIAL REPORTING AND ACCOUNTING STANDARDS

CHAPTER LEARNING OBJECTIVES

1. Describe the growing importance of global financial markets and their relation to financial reporting.
2. Explain the objective of financial reporting.
3. Identify the major policy-setting bodies and their role in the standard-setting process.
4. Discuss the challenges facing financial reporting.

TRUE-FALSE—Conceptual

1. Financial statements are the principal means through which financial information is communicated to those outside an enterprise.

2. Capital markets are increasingly integrated and companies have greater flexibility in deciding where to raise capital.

3. The major financial statements used under International Financial Reporting Standards (IFRS) include the statement of changes in financial position and the statement of stockholders' equity.

4. In order to provide information that is useful in decision making and capital allocation, the International Financial Reporting Standards (IFRS) requires all companies to use a common currency.

5. Users of the financial information provided by a company use that information to make capital allocation decisions.

6. An effective process of capital allocation promotes productivity and provides an efficient market for buying and selling securities and obtaining and granting credit.

7. Over 149 jurisdictions require or permit use of International Financial Reporting Standards (IFRS).

8. While objectives for financial reporting exist on an informal basis, no formal objectives have been adopted.

9. One weakness of accrual accounting is that it does **not** provide a good indication of the enterprise's present and continuing ability to generate favorable cash flows.

10. The passage of a new International Financial Reporting Standards Statement requires the support of ten of the thirteen board members.

11. International Financial Reporting Standards preceded International Accounting Standards.

12. The standard-setting structure used by the International Accounting Standards Board is very similar to that used by the Financial Accounting Standards Board.

13. The rules-based standards of IASB are more detailed than the simpler, principles-based standards of U.S. GAAP.

14. The International Accounting Standards Board issues International Financial Reporting Standards.

15. International Accounting Standards are no longer considered applicable because they have been replaced by International Financial Reporting Standards.

16. The standards issued by various standard-setting organizations around the world include standards that are profit-oriented and investor-focused.

17. The two major standard-setting organizations in the world are the International Accounting Standards Board (IASB) and International Organization of Securities Commission (IOSCO).

18. IFRS is considered more comprehensive than U.S. GAAP and the standards contain more implementation guidance than U.S. GAAP.

19. The International Organization of Securities Commissions (IOSCO) sets accounting standards for those countries which have **not** yet adopted IFRS.

20. The International Accounting Standards Board (IASB) follows specific steps in developing International Financial Reporting Standards (IFRS); the first step in the process is holding a public hearing.

21. A unanimous vote by all Board members is needed to issue a new International Financial Reporting Standard (IFRS).

22. The International Accounting Standards Board (IASB) has 13 members and each member of the IASB must come from a different country.

23. Interpretations issued by the IFRS Interpretations Committee are more authoritative than IASB Standards and Interpretations.

24. The International Accounting Standards Board (IASB) is a regulatory agency with enforcement powers for its International Financial Reporting Standards (IFRS).

25. International financial reporting interpretations (issued by the International Accounting Standards Board) are considered authoritative and must be followed.

26. Financial reports in the early 21st century did **not** provide any information about a company's soft assets.

27. Accounting standards are now less likely to require the recording or disclosure of fair value information due to its inherent subjectivity.

28. IFRS are a product of careful logic or empirical findings and are **not** influenced by political action.

29. The expectations gap is caused by what the public thinks accountants should be doing and what accountants think they can do.

30. Ethical issues in financial accounting are governed by the AICPA.

31. Politics and political pressure in establishing IFRS is a negative force.

32. Significant financial reporting issues facing global financial reporting and efficient capital allocation include how to provide backward-looking information.

33. The IASB relies primarily on the International Organization of Securities Commissions (IOSCO) for regulation and enforcement of its standards.

34. U.S. and European regulators have agreed to recognize each other's standards for listing on the various world securities exchanges.

35. IFRS tends to be simpler and more flexible in the accounting and disclosure requirements than U.S. GAAP.

True-False Answers—Conceptual

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

MULTIPLE CHOICE

36. The financial statements most frequently provided include all of the following **except** the
    a. statement of financial position.
    b. income statement.
    c. statement of cash flows.
    d. statement of retained earnings.

37. All the following are differences between financial and managerial accounting in how accounting information is used **except** to
    a. plan and control company's operations.
    b. decide whether to invest in the company.
    c. evaluate borrowing capacity to determine the extent of a loan to grant.
    d. All of these answers are differences.

38. Which of the following represents a form of communication through financial reporting but **not** through financial statements?
    a. Statement of financial position.
    b. President's letter.
    c. Income statement.
    d. Notes to financial statements.

P39. The process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, evaluate, and control an organization’s operations is called
    a. financial accounting.
    b. managerial accounting.
    c. tax accounting.
    d. auditing.

40. The major financial statements include all of the following **except**:
    a. Statement of financial position.
    b. Statement of changes in financial position.
    c. Statement of comprehensive income.
    d. Statement of changes in equity.

41. Which of the following statements is true?
    a. Over 149 jurisdictions require or permit use of International Financial Reporting Standards (IFRS).
    b. Canada is the most significant holdout from use of International Financial Reporting Standards (IFRS).
    c. Nearly 50% of investors in the United States own foreign securities, either directly or through funds.
    d. To facilitate efficient capital allocation, investors need relevant information stated in a common currency.

42. How does accounting help the capital allocation process attract investment capital?
    a. Provides timely, relevant information.
    b. Encourages innovation.
    c. Promotes productivity.
    d. Provides timely, relevant information and encourages innovation.

43. 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 answers are correct.

44. What would be an advantage of having all countries adopt and follow the same accounting standards?
    a. Consistency.
    b. Comparability.
    c. Lower preparation costs.
    d. Comparability and lower preparation costs

45. General-purpose financial statements are the product of
    a. financial accounting.
    b. managerial accounting.
    c. both financial and managerial accounting.
    d. neither financial nor managerial accounting.

46. Users of financial reports include all of the following **except**:
    a. creditors.
    b. government agencies.
    c. unions.
    d. All of these are users.

47. 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.

48. What is the major objective of financial reporting?
    a. Provide information that is useful to management in making decisions.
    b. Provide information that clearly portray nonfinancial transactions.
    c. Provide information that is useful to present and potential equity investors, lenders, and other creditors in making decisions..
    d. Provide information that excludes claims to the resources.

49. 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.

50. Accrual accounting is used because
    a. cash flows are considered less important.
    b. it provides a better indication of ability to generate cash flows than the cash basis.
    c. it recognizes revenues when cash is received and expenses when cash is paid.
    d. None of these answers are correct.

51. One element of the objective of financial reporting is to provide
    a. information about the investors in the business entity.
    b. information about the liquidation values of the resources held by the enterprise.
    c. information that is useful in assessing cash flow prospects.
    d. information that will attract new investors.

52. As part of the objective of general-purpose financial reporting, there is an emphasis on “assessing cash flow prospects.” Under International Financial Reporting Standards (IFRS) this is interpreted to mean:
    a. Cash basis accounting is preferred over accrual based accounting.
    b. Information about the financial effects of cash receipts and cash payments is generally considered the best indicator of a company’s present and continuing ability to generate favorable cash flows.
    c. Over the long run, trends in revenues and expenses are generally more meaningful than trends in cash receipts and disbursements.
    d. All of the choices are correct regarding “assessing cash flow prospects” under IFRS.

53. What is due process in the context of standard setting at the IASB?
 a. IASB operates in full view of the public.
 b. Public hearings are held on proposed accounting standards.
 c. Interested parties can make their views known.
 d. All of these answers are correct.

54. Which of these statements regarding the IFRS and U.S. GAAP is correct?
 a. U.S. GAAP is considered to be "principles-based" and more detailed than IFRS.
 b. U.S. GAAP is considered to be "rules-based" and less detailed than IFRS.
 c. IFRS is considered to be "principles-based" and less detailed than U.S. GAAP
 d. Both U.S. GAAP and IFRS are considered to be "rules-based", but U.S. GAAP tends to be more complex.

55. The IASB's standard-setting structure includes all of the following **except**:
 a. IFRS Interpretations Committee
 b. IFRS Advisory Council
 c. IFRS Comparison Committee
 d. Trustees

P56. The following published documents are part of the "due process" system used by the IASB in the evolution of a typical IASB Standard

 1. Exposure Draft
 2. IASB Standard
 3. Discussion Paper

 The chronological order in which these items are released is as follows:
 a. 1, 2, 3.
 b. 1, 3, 2.
 c. 2, 3, 1.
 d. 3, 1, 2.

57. The purpose of the International Accounting Standards Board is to
 a. issue enforceable standards which regulate the financial accounting and reporting of multinational corporations.
 b. develop a uniform currency in which the financial transactions of companies throughout the world would be measured.
 c. develop a single set of high-quality IFRS.
 d. arbitrate accounting disputes between auditors and international companies.

58. In the past, many countries have relied on their own standard-setting organizations. The standards issued by these various standard-setting organizations around the world include
 a. Tax-oriented standards.
 b. Business-based standards.
 c. Principles-based standards.
 d. All of these answers are correct.

59. The two major standard-setting organizations in the world are
    a. Financial Accounting Standards Board (FASB) and the International Organization of Securities Commission (IOSCO).
    b. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).
    c. The International Accounting Standards Board (IASB) and International Organization of Securities Commission (IOSCO).
    d. The International Accounting Standards Board (IASB) and the Standards Advisory Council (SAC).

60. When comparing U.S. GAAP and International Financial Reporting Standards (IFRS)
    a. IFRS are considered more comprehensive than U.S. GAAP.
    b. IFRS contain more implementation guidance than U.S. GAAP.
    c. IFRS are considered more principles-based than U.S. GAAP.
    d. All of the choices are correct regarding U.S. GAAP and IFRS.

61. Which of the following organizations is **not** among the four international standard-setting organizations?
    a. IFRS Foundation.
    b. IFRS.
    c. IFRS.
    d. International Organization of Securities Commissions (IOSCO).

62. The International Accounting Standards Board (IASB) follows specific steps in developing International Financial Reporting Standards (IFRS). Place the following steps in the correct order:
    1) Research and analysis conducted; preliminary views of pros and cons issued.
    2) Topics identified and placed on the agenda.
    3) Board evaluates responses, final standard issued.
    4) Public hearing on proposed standard
    5) Board evaluates research, issues exposure draft.

    a. 1, 2, 3, 4, 5
    b. 2, 1, 4, 5, 3
    c. 1, 2, 5, 4, 3
    d. 1, 2, 5, 3, 4

63. Which of the following is true with regard to the characteristics of the International Accounting Standards Board (IASB)?
    a. A unanimous vote by all Board members is needed to issue a new International Financial Reporting Standard (IFRS).
    b. The IASB consists of 13 part-time members.
    c. Each member of the IASB must come from a different country.
    d. IASB members are appointed for 5-year renewable terms.

64. International financial reporting interpretations (issued by the International Accounting Standards Board)
    a. Are considered authoritative and must be followed.
    b. Cover newly identified financial reporting issues not specifically addressed by the IASB.
    c. Cover issues where unsatisfactory or conflicting interpretations have developed.
    d. All of the choices are correct regarding International financial reporting interpretations.

65. Which of the following statements is true regarding the International Accounting Standards Board (IASB)?
    a. The IASB is a regulatory agency with enforcement powers for its International Financial Reporting Standards (IFRS).
    b. The IASB is a public organization, funded by taxpayer dollars from member countries.
    c. Is comprised of 13 members.
    d. All of the choices are correct regarding the IASB.

66. Which of the following is **not** one of the major types of pronouncements issued by the International Accounting Standards Board (IASB)?
    a. International financial reporting standard.
    b. Memorandum of understanding.
    c. Framework for financial reporting.
    d. International financial reporting interpretations.

67. Which of the following has the highest authoritative support?
    a. International Financial Reporting Standards.
    b. International Accounting Standards.
    c. Interpretations of the IFRIC.
    d. Framework for Financial Reporting.

68. Financial statements in the early 2000s provided information related to
    a. nonfinancial measurements.
    b. forward-looking data.
    c. hard assets (inventory and plant assets).
    d. None of these answers are correct.

69. Which of the following is **not** a major challenge facing the accounting profession?
    a. Nonfinancial measurements.
    b. Timeliness.
    c. Accounting for hard assets.
    d. Forward-looking information.

70. What is a possible danger if politics plays too big a role in developing IFRS?
    a. Financial reporting standards that are issued that are not truly generally accepted.
    b. Individuals may influence the standards.
    c. User groups become active.
    d. The IASB delegates its authority to elected officials.

71. What is "expectation gap"?
    a. The difference between what the public thinks the accountant is not doing and what the accountant knows they don't do.
    b. The difference between what the public thinks the accountant should do and what Congress says the accountant should do.
    c. The difference between what the public thinks the accountant should do and what the accountant thinks they can do.
    d. The difference between what the accountant should do and what the Courts say the accountant should be doing.

72. Which of the following is an ethical concern of accountants?
    a. Earnings manipulation.
    b. Conservative accounting.
    c. Industry practices.
    d. None of the above.

73. The international financial reporting environment includes challenges in financial reporting including all of the following **except**:
    a. Political environment.
    b. Expectations gap.
    c. Decision-usefulness.
    d. Ethics.

74. Significant financial reporting issues facing global financial reporting and efficient capital allocation include all of the following **except**:
    a. How to provide backward-looking information.
    b. How to report nonfinancial measures such as customer satisfaction.
    c. How to provide forward-looking information.
    d. How to provide real-time financial statement information.

75. Non-financial measurements include all of the following **except**:
    a. backlog information.
    b. customer satisfaction indexes.
    c. reject rates on goods purchased.
    d. All of the choices are non-financial measurements.

Multiple Choice Answers

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
36.	d	42.	a	48.	c	54.	c	60.	c	66.	b	72.	a
37.	d	43.	d	49.	c	55.	c	61.	d	67.	a	73.	c
38.	b	44.	d	50.	b	56.	d	62.	b	68.	c	74.	a
39.	b	45.	a	51.	c	57.	c	63.	d	69.	c	75.	d
40.	b	46.	d	52.	c	58.	d	64.	d	70.	a		
41.	a	47.	a	53.	d	59.	b	65.	c	71.	c		

EXERCISES

Ex. 1-76—Objective of financial reporting.

What is the objective purpose of general-purpose financial reporting?

Solution 1-76

The objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions about providing resources to the entity.

Information that is decision-useful to capital providers (investors) may also be useful to other users of financial reporting who are not investors.

Ex. 1-77—Due process

In establishing financial accounting standards, the IASB has a thorough, open, and transparent due process. List the elements that comprise the IASB due process.

Solution 1-77

1. An independent standard-setting board overseen by a geographically and professionally diverse body of trustees.
2. A thorough and systematic process for developing standards.
3. Engagement with investors, regulators, business leaders, and the global accountancy profession at every stage of the process.
4. Collaborative efforts with the worldwide standard-setting community.

Ex. 1-78—IASB.

List and discuss the characteristics of the International Accounting Standards Board (IASB) that reinforce the importance of an open, transparent and independent process.

Solution 1-78

1. Membership. The Board consists of 13 members. Members are well-paid and appointed for five-year renewable terms. The 13 members come from different countries.
2. Autonomy. The IASB is not part of any other professional organization. It is appointed by and answerable only to the IFRS Foundation.
3. Independence. IASB members must sever all ties from their past employer. The members are selected for their expertise in standard-setting rather than to represent a given country.
4. Voting. Seven of 13 votes are needed to issue a new IFRS.

Ex. 1-79—Evolution of a statement of financial accounting standards.

In establishing financial accounting standards, two basic premises of the IASB are (1) The IASB 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 steps does the IASB follow in the development of a typical IFRS?

Solution 1-79

The steps in the development of an IFRS are:

a. Topics are identified and placed on the Board's agenda.
b. Research and analysis are conducted and preliminary views of pros and cons are 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. 1-80—Common set of standards

Why would it be advantageous for U.S. GAAP and IFRS to be the same?

Solution 1-80

Relevant and reliable financial information is a necessity for viable capital markets. Unfortunately, financial statements from companies outside the United States are often prepared using different principles than U.S. GAAP. As a result, international companies have to develop financial information in different ways. Beyond the additional costs these companies incur, users of financial statements are often forced to understand at least two sets of GAAP. It is not surprising that there is a growing demand for one set of high quality international standards.

Ex. 1-81—Principles-based versus rules-based standards

What is the difference between principles-based and rules-based accounting rules? Are IFRS more principles-based than U.S. GAAP? Explain.

Solution 1-81

Principles-based rules are considered to be based on broad accounting principles aimed at ensuring that companies' financial statements are fairly presented. Rules-based standards are generally quite detailed, and in many instances follow a "check-box" mentality that some contend may shield auditors and companies from legal liability. Because IFRS tend to be simpler and less stringent in accounting and disclosure requirements, they are generally considered more principles-based than U.S. GAAP.