Financial Accounting Version 3 3rd edition Hoyle Test Bank

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Chapter 2
What Should Decision Makers Know in Order to Make Good Decisions about an Organization?

Section 1

True/False Questions

1. Financial accounting can be compared to a portrait.
   True; Easy

2. Financial statements provide the form and structure for the conveyance of financial information that will create a likeness of the reporting organization.
   True; Moderate

3. The information reported in financial statements must be exact for an investor to make any decision.
   False; Easy

4. Investors and creditors do not need absolute accurate information to make decisions on a company.
   True; Easy

5. Financial information should be free of material misstatements
   True; Easy

6. A misstatement is deemed to be material if its presence impacts a decision.
   True; Moderate

7. Errors and frauds are the two types of misstatements.
   True; Easy

8. No material misstatements are allowed if financial statements are to be called fairly presented.
   True; Moderate

9. Materiality is relative to the size of an organization.
   True; Moderate

10. Fraud includes intent to deceive and is more troublesome to decision makers than a mere error.
    True; Easy

11. Size is the only consideration in determining whether a misstatement will have an impact on a decision maker's actions or not.

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False; Hard

12. Material misstatements prevent financial information from being fairly presented.
    True; Moderate

Multiple Choice Questions

13. Which of the following is true of financial statements?
    a. Financial statements are distributed only to the employees of a company.
    b. Financial statements are limited to a representation of a company's operation.
    c. Financial statements will create a likeness of the reporting organization.
    d. Financial statements provide employee details.
    e. Financial statements are exactly accurate.
    c; Easy

14. Which of the following is a factor pertaining to knowledge of information that will affect a decision made by a user from that information?
    a. Materiality
    b. Representation faithfulness
    c. Error
    d. Misstatement
    e. Fraud
    a; Moderate

15. Financial statements are a representation of an organization's:
    a. frauds.
    b. operations.
    c. competitors.
    d. threats.
    e. work union.
    b, Moderate

16. Which of the following are the two types of misstatements?
    a. Materiality and fraud
    b. Fraud and errors
    c. Errors and mismatch
    d. Materiality and errors
    e. Fraud and issues
    b; Moderate

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17. Which of the following is an intentional misstatement?
    a. Error
    b. Mistake
    c. Representational faithfulness
    d. Fraud
    e. Materiality
    d; Easy

18. Which of the following is an accidental misstatement?
    a. Error
    b. Materiality
    c. Representational faithfulness
    d. Irrelevance
    e. Fraud
    a; Easy

19. Which of the following factors is considered in judging if the misstatements are material?
    a. People responsible for the misstatement
    b. Profits made by the company
    c. Number of employees in the company
    d. Size and cause of the misstatement
    e. Competitor's profits
    d; Moderate

20. Financial information is not fairly presented if it contains:
    a. verbal explanations
    b. intangible assets.
    c. material misstatement.
    d. contingent liability.
    e. assumptions.
    c; Easy

21. Which of the following is true of misstatement?
    a. A misstatement is of two types: inconsistency and inaccuracy.
    b. Misstatement always leads to liquidation of a company.
    c. Only the cause should be weighed in considering whether the misstatement is material or not.
    d. A misstatement is deemed to be material if it is so significant that its presence would impact a decision made by an interested party
    e. Financial information is said to be fairly presented, even though material misstatement exists.
    d; Moderate

22. The communication of an appropriate picture of an organization, which can serve as the basis for appropriate decisions is termed as:

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a. representational faithfulness.
b. material misstatement.
c. conservatism.
d. principle of prudence.
e. certainty.
a; Easy

23. An error (made accidentally) or fraud (done intentionally) where reported figures or words actually differ from the underlying reality is called a(n):
a. inconsistency.
b. insincerity.
c. misstatement.
d. uncertainty.
e. materiality.
c; Easy

24. Which of the following statements is true of financial information?
a. It should always be exactly accurate.
b. It does not represent the likeliness of an organization, if it is not exact.
c. It is free from uncertainties.
d. It can be useful even if it is not exact.
e. It almost always does contains material misstatements.
d; Moderate

25. Financial information that contains no material misstatements in accordance with an accepted standard for financial reporting is termed as:
a. free from uncertainty.
b. fairly presented .
c. fraudulent reporting.
d. universal reporting.
e. inconsistent.
b; Easy

26. Quantitative reports and related verbal disclosures that convey monetary information as a basis for representing its financial health and future prospects are called:
a. misstatements.
b. supplemental statements.
c. financial statements.
d. statement of notes and disclosures.
e. annexures.
c; Easy

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27. A company constructs a building and reports the cost of construction at $400 million. Which of the following is a true statement?
    a. The company cannot spend more than $400 million on the building.
    b. The accountant would never let the amount of $400 million be reported if it were not right down to the penny.
    c. Reporting $400 million in the financial statement will lead to material misstatement.
    d. To be fairly presented, the true cost of the building cannot be materially different from $400 million.
    e. Investors will expect that $400 million was the exact cost of the building.
    d; Moderate

Fill In the Blanks

28. Financial information reported to decision makers should not contain _____ misstatements.
    material; Easy

29. The two types of misstatements are _____ and _____.
    errors and fraud; Easy

30. A misstatement is _____ if its presence would impact a decision made by an interested party.
    material; Moderate

31. The two factors that influence the materiality of a misstatement are the _____ and the _____ of the misstatement.
    size, cause; Easy

Short Answer Questions

32. Explain the difference between a material and a non-material misstatement.

    A misstatement is material if a decision maker would make a different decision if the correct information had been reported. A non-material misstatement will not cause the user to make a different decision than if the correct information had been reported.
    Easy

33. Explain how financial accounting is like painting a portrait.

    The purpose of a portrait is to capture a person's likeness; the purpose of financial accounting is to capture the likeness of an organization that can help decision makers. Just as portraits are not a perfect copy of a person, financial accounting does not purport to be exact.
    Easy

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34. Name the two types of misstatements and explain how they differ.

    The two types of misstatements are errors and fraud. Errors are made accidentally, while fraud is done intentionally.
    Easy

35. Explain why decision makers do not expect financial information to be exact.

    Exactness with financial information is rarely possible. Users understand this. As long as no material misstatements exist, users can rely on the financial information to help them make decisions.
    Moderate

Section 2

True/False Questions

36. Many of the events encountered everyday by an organization contains some degree of uncertainty.
    True; Easy

37. Salary Expense to be paid by a company would be an example of an uncertainty faced by a company.
    False; Easy

38. Accounting is the language of business.
    True; Easy

39. Effective communication requires set terminology and, structural rules and principles.
    True; Moderate

40. Financial accounting has its own terminology.
    True; Easy

41. It is important for non-accountants to understand the terminology of accounting if they wish to make financial decisions about a company.
    True; Easy

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Multiple Choice Questions

42. Which of the following is an example of an uncertainty faced by an organization?
    a. Monthly rent expense paid on office building
    b. Cash balance reported on a bank statement
    c. Annual salary paid to an employee
    d. Current cash balance reported on a company's financial statement
    e. Cash bonus to be paid to employees based on company's stock price
    e; Easy

43. Which of the following statements is true of financial accounting?
    a. Exactness is the goal of financial accounting.
    b. Financial accounting information is free from uncertainties.
    c. Accounting is referred to as the "language of business".
    d. Financial accounting doesn't have its own set of terminology, making it difficult to interpret financial information.
    e. Financial accounting is limited to access the future prospects of an organization.
    c; Easy

44. Which of the following is a requirement for successful communication of financial information?
    a. Presence of exact numbers
    b. Nonexistence of uncertainties
    c. The structural rules must be understood by all parties involved.
    d. Receiver being a close-minded
    e. Nonexistence of defined set of terminology
    c; Easy

45. As accounting is a business language, which of the following guides the reporting process so that the resulting accounting information will be fairly presented and readily understood by all interested parties?
    a. Guidance document attached to financial statements
    b. Grammar rules
    c. Syntax and punctuation
    d. Structural rules and principles
    e. Decision-making process
    d; Moderate

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46. Which of the following is one of the major challenges faced by an accountant?
    a. Deciding which accounting standard to follow
    b. Determining if a transaction is affecting asset, liability, revenue or expense
    c. Setting structural rules and principles for reporting
    d. Reporting events in the face of uncertainty
    e. Developing terminologies for financial accounting
    d; Easy

47. Accounting is sometimes referred to as the language of business because:
    a. it overstates profit and understates loss made by the company.
    b. it give the details of employees working in a company.
    c. it communicates a portrait of financial health of an organization.
    d. it has less terminologies.
    e. it uses generally accepted accounting standards.
    c; Easy

Fill In the Blanks

48. _____ is sometimes referred to as the language of business.
    Accounting; Easy

49. Almost every Organization faces _____ like lawsuits when presenting financial information.
    uncertainties; Easy

Short Answer Questions

50. Explain how accounting is like a language.

    Accounting is the language that allows organizations to communicate their financial health and future prospects to decision makers using words and numbers. Like other languages, accounting has a set terminology and structural rules and principles, which allow for effective communication.
    Easy

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51. Explain how knowledge of the language of accounting will benefit a non-accountant.

Financial accounting conveys information, which helps users make decisions about the financial health of an organization. Those who evaluate loan applications, buy capital stock, grant credit, make employment decisions, and provide investment advice need to speak the language of accounting just as accountants do. The more such individuals know about financial accounting terminology, rules, and principles, the more likely it is that they will arrive at appropriate decisions.
Easy

52. Name three uncertainties faced by businesses trying to present their financial information.

Uncertainties faced by organization are:

1) Lawsuits
2) Sales of merchandise on credit
3) Promises to pay employee bonus based on future earnings
Easy

Section 3

True/False Questions

53. If both the accountant and the decision maker understand U.S. GAAP, financial statements should be conveyed successfully.
True; Easy

54. Accounting principles evolve quickly as the nature of business changes and new reporting issues, problems, and resolutions arise.
True; Easy

55. U.S. companies grow and prosper by convincing investors and creditors to contribute money to them.
True; Moderate

56. Investors and creditors want to assess the risks and rewards before providing financing for a company.
True; Easy

57. U.S. GAAP is primarily created by the Securities and Exchange Commission.
False; Moderate

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58. A change in U.S. GAAP can take years, as changes are never made without proper consideration.
True; Easy

59. The FASB is the only creator of U.S. GAAP.
False; Easy

60. The United States has not yet adopted IFRS for financial reporting.
True; Moderate

61. IFRS is more rules based, while U.S. GAAP is more principles based.
False; Hard

Multiple Choice Questions

62. GAAP stands for:
a. Generally Accepted Accounting Principles.
b. Generally Applied Accounting Principles.
c. Generally Accepted Accounting Procedures.
d. Governmentally Applied Accounting Procedures.
e. Governmentally Accepted Accounting Procedures.
a; Easy

63. The FASB stands for:
a. Federal Accounting Standards Board.
b. Foreign Average Standards Business.
c. Federal Accounting Securities Business.
d. Financial Accounting Securities Board.
e. Financial Accounting Standards Board.
e; Easy

64. The group primarily responsible for setting accounting standards in the United States is the:
a. American Institute of Certified Public Accountants (AICPA)
b. Securities and Exchange Commission (SEC)
c. Standing Interpretations Committee (SIC)
d. International Accounting Standards Board (IASB)
e. Financial Accounting Standards Board (FASB)
e; Easy

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65. Which of the following is true of U.S. GAAP?
    a. U.S. GAAP is principles-based set of standards. .
    b. U.S. GAAP is primarily created by the International Accounting Standards Board.
    c. U.S GAAP is currently not used by any countries in U.S.
    d. A company in Georgia and a company in Virginia are both subject to the rules of U.S. GAAP.
    e. U.S. GAAP has been in existence since World War I.

    d; Moderate

66. International Financial Reporting Standards (IFRS) are produced by the:
    a. Standing Interpretations Committee (SIC).
    b. International Accounting Standards Board (IASB).
    c. Financial Accounting Standards Board (FASB).
    d. Securities and Exchange Commission (SEC).
    e. Public Company Accounting Oversight Board (PCAOB).

    b; Easy

67. Which of the following is true of IFRS?
    a. IFRS are applied to most of financial information presented within the United States.
    b. IFRS is rules-based set of standards.
    c. The Financial Accounting Standards Board (FASB) has held the authority to develop IFRS since 1973.
    d. IFRS is more based on principles.
    e. IFRS is entirely different from standards set by U.S. GAAP.

    d; Moderate

68. A few companies in the U.S. do not favor switching financial reporting from U.S. GAAP to IFRS. Which of the following is a possible reason for this?
    a. The switching will cost the companies lot of money.
    b. Switching would make it difficult to raise capital around the world.
    c. IFRS allows the preparers of financial information more judgment in applying general rules, which leads to inconsistency.
    d. IFRS are very rules-based set of standards that is difficult to navigate.
    e. Consolidated bookkeeping is a very complex task.

    a; Moderate

69. Which of the following is an importance of accounting standards?
    a. It helps in making financial reporting free from uncertainties.
    b. It helps in projecting a loss-incurring company as a profit-making company..
    c. It helps in evaluating the financial health and future prospects of an organization.
    d. It helps in reporting the financial information with exactness.
    e. It helps in covering the material misstatements made unintentionally.

    c; Easy

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70. The Financial Accounting Standards Board (FASB) is:
    a. a governmental organization.
    b. in charge of the creation of IFRS.
    c. an independent group supported by the U.S. government, various accounting organizations, and many private businesses.
    d. responsible for amending present accounting rules, but doesn't have the right to pass new rules.
    e. against the switching of financial reporting from U.S GAAP to IFRS in United States.

    c; Moderate

71. Which of the following statement is true of U.S. GAAP?
    a. The IASB issues U.S. GAAP.
    b. Investors and creditors would be just as likely to contribute money to companies even if U.S. GAAP did not exist.
    c. U.S. GAAP can also be called as International Financial Reporting Standards.
    d. Without U.S. GAAP, investors and creditors would encounter significant difficulties in evaluating the financial health and future prospects of an organization.
    e. U.S. GAAP has limited the development and expansion of thousands of businesses.

    d; Easy

72. Which of the following is a true statement?
    a. U.S. GAAP enables decision makers to obtain information needed to reduce the risk of investment.
    b. The Financial Accounting Standards Board (FASB) has held the authority to develop IFRS since 1973.
    c. IFRS is used only by the countries with capitalist economy.
    d. Changes to U.S. GAAP are made without proper changes.
    e. U.S. GAAP is used only by governmental organizations.

    a; Easy

73. IFRS is more principles based, whereas, U.S. GAAP is more:
    a. ethics based.
    b. rules based.
    c. codes based.
    d. ideologies based.
    e. philosophies based.

    b; Easy

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Fill In the Blanks

74. The _____ is primarily responsible for creating U.S. GAAP.
FASB; Easy

75. _____allows businesses in Oregon and Mississippi to account for financial information in the same manner.
U.S. GAAP; Easy

76. To grow, U.S. companies must convince _____ and _____ to contribute money voluntarily.
creditors and investors; Easy

77. There continues to be conversation regarding the United States considering switching from U.S. GAAP to _____.
IFRS; Moderate

Short Answer Questions

78. Explain the role of the Financial Accounting Standards Board.

The Financial Accounting Standards Board is an independent body that has been tasked with creating accounting standards for businesses in the United States. It has been in existence since 1973. When an accounting issue arises about which companies need guidance, FASB steps in to study the issues and alternatives. After a period of study, the board might pass new rules or make amendments to previous ones. FASB is methodical in its deliberations and the entire process can take years. Changes to U.S. GAAP are never made without proper consideration.
Moderate

79. Explain the importance of U.S. GAAP to businesses in the United States.

Businesses in the United States must convince outside investors and creditors to invest or loan them money if they wish to operate and grow. Obviously, this entails risk on the part of the investor or creditor. Decision makers must believe that they are using reliable data to make reasonable estimations of future stock prices, cash dividends, and cash flows. Without rules for financial reporting, this analysis would be difficult, if not impossible. U.S. GAAP enables outside parties to obtain the financial information they need to reduce their perceived risk to acceptable levels. It provides rules for financial reporting. If investors and creditors understand these rules, they can analyze a company's financial statements to help them determine whether they should invest in a particular company or not. The U.S. economy would not be what it is today without GAAP.
Moderate

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Section 4

True/False Questions

80. An asset is a probable future economic benefit owned or controlled by an organization.
True; Easy

81. Inventory is an example of an asset.
True; Easy

82. Liabilities are amounts contributed by owners.
False; Moderate

83. Notes due to banks are an example of a liability.
True; Easy

84. A retained earnings is an example of an asset.
False; Easy

85. Sale of office building by a textile manufacturing company is considered as revenue.
False; Easy

86. Revenue is a measure of the financial impact on an organization that results from a sale.
True; Easy

87. The balance of total net assets is also known as equity.
True; Moderate

88. An expense is an inflow of net assets.
False; Easy

89. Salaries paid to employees are an example of an expense.
True; Easy

Multiple Choice Questions

90. Probable future sacrifice of economic benefits arising from present obligations is termed as a(n):
a. revenue.
b. expense.
c. net asset.
d. asset.
e. liability.
e; Easy

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91. Which of the following is true of revenue?
    a. It is a probable future economic benefit owned or controlled by an organization.
    b. Unearned revenue and investments are examples of revenue.
    c. It is the lifeblood of any organization.
    d. It reflects decrease in net assets.
    e. It is opposite of liability.
    c; Easy

92. Which of the following is true of an expense?
    a. It is a probable future sacrifice of economic benefits arising from present obligation.
    b. Note payable and outstanding expenses are examples of expense.
    c. It reflects decrease in net assets.
    d. It is incurred in hopes of generating assets.
    e. It is the lifeblood of any organization.
    c; Easy

93. Unearned revenue and outstanding expense are examples of a(n):
    a. asset.
    b. liability.
    c. revenue.
    d. expense.
    e. Owners' equity.
    b; Easy

94. Which of the following is an example of an expense?
    a. Building
    b. Debt
    c. Salaries
    d. Sales
    e. Cash
    c; Easy

95. Which of the following is an example of an asset?
    a. Note payable
    b. Inventory
    c. Sales
    d. Retained earnings
    e. Unearned revenue
    b; Easy

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96. Sales is an example of a(n):
    a. revenue.
    b. asset.
    c. expense.
    d. misstatement.
    e. liability.
    a; Easy

97. Equipment is an example of a(n):
    a. liability.
    b. expense.
    c. error.
    d. revenue.
    e. asset.
    e; Easy

98. Net asset is calculated by subtracting:
    a. current liabilities from current assets.
    b. total liabilities from total assets.
    c. current assets from current liabilities.
    d. current assets from total assets.
    e. expenses from revenue.
    b; Easy

99. Vistas Wind Systems pays salaries to its employees at the end of each month. At the end of February, the company paid $3,000 towards salaries expenses. Out of $3,000, $1,200 is for the month of February and $1,800 is for the month of March. Which of the following statements is true?
    a. $3,000 will be reported as expense for the month.
    b. $1,800 will be reported as expense for the month.
    c. $3,000 will be reported as asset for the month.
    d. $1,200 will be reported as expense and $1,800 will be reported as asset for the month.
    e. $1800 will be reported as expense and $1,200 will be reported as a liability for the month.
    d; Hard

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100. In Year One, Double Design Corporation purchased equipment costing $5,000 for cash. Which of the following statements is true of this transaction?
   a. The company will report an expense of $5,000.
   b. The company's net asset will increase by $5,000.
   c. The company's net asset would have decreased had the equipment been purchased on account.
   d. The company will report a liability of $5,000.
   e. The company's net asset will not change because of this transaction.
   e; Moderate

101. Roberto's Autos sells used cars and trucks. Roberto pays a monthly rental for the building in which his salespeople operate. The company owns the land on which the cars and building sit. Roberto makes most of his sales on credit. Last month, sales amounted to $45,000. Roberto pays salaries to his employees and pays to advertise his business. Which of the following is an asset owned by Roberto?
   a. Tax paid on land
   b. Advertising
   c. Rent expense
   d. Credit sales
   e. Amounts owed by customers
   e; Easy

102. Haley's Hair Salon specializes in cuts and color for all hair types. Haley also sells beauty products. Last week, Haley borrowed $10,000 from the bank to buy new equipment for the salon. Which of the following is a true statement?
   a. If Haley sells the equipment, the amount realized from the sale will be reported as revenue.
   b. The amount borrowed from bank will increase the amount of owners' equity.
   c. The $10,000 received from the bank is revenue for Haley.
   d. The beauty products Haley has in stock are an expense to her.
   e. Haley earns revenue by cutting hair.
   e; Moderate

Fill in the blanks

103. A(n) _____ is an amount owed to another party.
   liability; Easy

104. A(n) _____ is a decrease in net assets to generate revenue.
   expense; Easy

105. A(n) _____ is a future economic benefit owned or controlled by a company.
   asset; Easy

Short Answer Questions

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106. Fill in each of the following with a (A) if it is an asset, a (L) if it is a liability, a (R) if it is revenue, and a (E) if it is an expense.
    a. Building__ **A**___
    b. Bank note_ L____
    c. Sale of services_ R____
    d. Equipment__ A___
    e. Insurance expense__ E____
    f. Cash_ A____
    g. Inventory__ A____
    h. Sale of goods__ R____
    Moderate

107. Explain the terms asset, liability, revenue, and expense.

    Asset: A probable future economic benefit owned or controlled by the reporting company, such as inventory, land, or equipment.
    Liability: A probable future economic sacrifice or, in simple terms, a debt.
    Revenue: A measure of the inflow or increase in net assets generated by the sales made by a business. It is a reflection of the amounts brought in by the sales process during a specified period of time.
    Expense: A measure of the outflow or reduction in net assets caused by a business's attempt to generate revenue.
    Easy

108. Give two examples for each of the following: asset, liability, revenue, expenses.

    Asset: Cash and Building
    Liability: Note Payable and Outstanding expenses
    Revenue: Sale of goods and sale of services
    Expense: Rent expense and Salary expense
    Easy

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