

## Chapter 1 – Introduction to accounting

### TRUE/FALSE

1. An objective of accounting is to provide information to predict and evaluate the going concern of an entity.

ANS: T                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: What is accounting?

2. Accounting information is always quantitative and objective.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: What is accounting?

3. Stewardship is the term used to refer to management's role in protecting an entity's economic resources from theft, fraud and wastage.

ANS: T                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting used?

4. Management is an external user of accounting information.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

5. The balance sheet is an example of a management accounting report.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

6. The statement of comprehensive income is an example of a financial accounting report.

ANS: T                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

7. The difference between management accounting and financial accounting is that management accounting focuses on external users whereas financial accounting focuses on internal users.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting used?

8. Management has the responsibility of selecting accounting policies.

ANS: T                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

9. Where an Accounting Standard exists, accounting policies must comply with the Accounting Standard.

ANS: T                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

10. The economic consequences of accounting information are limited to the compensation schemes paid to managers.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

11. Political costs create incentives for managers to select accounting policies that increase reported profits.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

12. Triple bottom line reporting confirms the maximisation of profit as the major objective of listed companies.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

13. A triple bottom line report refers to the publication of economic, environmental and corporate governance information in an integrated report.

ANS: F                      PTS: 1                      AACSB:                      Knowledge  
TOP: Integrated reporting.

14. Because triple bottom line reports are voluntary, the provision of an independent verification of the reports should enhance the reliability of the information provided.

ANS: T                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

15. The GRI indicators are established by the committee without any input from stakeholders.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

16. The audit of a triple bottom line report is normally completed by the financial auditor.

ANS: F                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

## **MULTIPLE CHOICE**

1. Accounting information:
- A. is helpful for financing decisions but not for marketing decisions.
  - B. is useful for profit-making entities but is not needed for not-for-profit entities.
  - C. must follow accounting principles provided by management.
  - D. is useful for all economic organisations.

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: What is accounting?

2. The primary purpose of accounting is to:

- A. help people make decisions about economic activities.
- B. provide information that management can use to convince shareholders that management deserves high salaries.
- C. provide employment to persons who have a knack for dealing with numbers.
- D. minimise the amount of profit that a firm has earned.

ANS: A                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: What is accounting?

3. Accounting is *likely* to involve:
- A. qualitative and financial information.
  - B. quantitative and financial information.
  - C. quantitative and non-financial information.
  - D. qualitative and non-financial information.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: What is accounting?

4. For the individual, accounting has at least three functions. They are:
- A. planning, buying and selling.
  - B. planning, decision support and spending.
  - C. saving, controlling and buying.
  - D. planning, controlling and decision support.

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: What is accounting?

5. The difference between management accounting and financial accounting is:
- A. management accounting focuses on external users whereas financial accounting focuses on internal users.
  - B. management accounting focuses only on the control function whereas financial accounting focuses on the reporting function.
  - C. management accounting focuses on internal users whereas financial accounting focuses on external users.
  - D. management accounting focuses on the reporting function whereas financial accounting focuses on the control function.

ANS: C                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting information used?

6. Examples of internal and external users of information are:
- A. suppliers and investors.
  - B. managers and unions.
  - C. suppliers and unions.
  - D. banks and government authorities.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

7. The basic difference between managerial accounting and financial accounting is that:
- A. the financial accounting system relies on accounting information whereas managerial accounting does not.
  - B. financial accounting relies on information gathered from sources outside the business whereas managerial accounting relies on internally generated information.
  - C. financial accounting is concerned with providing information to outsiders, whereas

managerial accounting is concerned with providing information to managers for their use in directing the activities of the organisation.

- D. managerial accounting information is useful to not-for-profit organisations, but financial accounting information is not.

ANS: C                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting information used?

8. Which of the following is an example of a stakeholder of a business?  
A. An owner  
B. An investor  
C. A manager  
D. All of the above

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

9. Financial accounting is the process of:  
A. preparing and reporting accounting information for external decision makers.  
B. preparing and reporting accounting information for internal decision makers.  
C. enacting generally accepted accounting principles.  
D. preparing and reporting accounting information to lenders.

ANS: A                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting information used?

10. Management accounting is the process of:  
A. preparing and reporting accounting information for external decision makers.  
B. preparing and reporting accounting information for an organisation's internal decision makers.  
C. enacting generally accepted accounting principles.  
D. preparing and reporting accounting information to lenders.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting information used?

11. Match the type of accounting information to the term that best describes it.

<b><u>Information prepared for external decision makers</u></b>	<b><u>Information prepared for internal decision makers</u></b>
A. Financial accounting	Financial accounting
B. Financial accounting	Managerial accounting
C. Managerial accounting	Financial accounting
D. Managerial accounting	Managerial accounting

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting information used?

12. Information contained in external financial reports can be useful to a firm's:

<b><u>Suppliers</u></b>	<b><u>Employees</u></b>
A. No	No
B. No	Yes
C. Yes	No
D. Yes	Yes

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

13. Match the type of accounting information to the term that best describes it.

<b><u>Information prepared for suppliers' use</u></b>	<b><u>Information prepared for creditors' use</u></b>
A. Managerial accounting	Financial accounting
B. Managerial accounting	Managerial accounting
C. Financial accounting	Financial accounting
D. Financial accounting	Managerial accounting

ANS: C                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: For what purpose is accounting information used?

14. Which one of the following groups is not generally regarded as an external user of the accounting information of an entity?
- A. Employees
  - B. Customers
  - C. Management
  - D. Lenders

ANS: C                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Who uses accounting information?

15. A possible limitation of accounting information is that accounting information:
- A. can only be used by bankers.
  - B. is relevant depending on the needs of users.
  - C. does not report in money terms.
  - D. relates to past information.

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Limits on the usefulness of accounting information.

16. The selection of appropriate accounting policies for a company is the responsibility of:
- A. the body that sets Accounting Standards.
  - B. the company secretary.
  - C. the internal auditors of the company.
  - D. the management of the company.

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

17. What is meant by the term *economic consequences of accounting policy choice*?
- A. The selection of accounting policies is expensive and time-consuming.
  - B. Accounting numbers affect the financial positions of various users.
  - C. Accounting policies are selected to minimise the position of creditors.
  - D. The creation of accounting standards consumes a large amount of resources.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

18. In a firm that offers a bonus scheme based on accounting profit, managers can, in most cases, be expected to adopt a:
- A. profit-decreasing accounting policy.

- B. profit-increasing accounting policy.
- C. dividend-increasing accounting policy.
- D. liability-increasing accounting policy.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

19. Debt covenants primarily protect the interests of which of the following parties?
- A. Shareholders
  - B. Lenders
  - C. Employees
  - D. Companies

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

20. Triple bottom line reporting
- A. reinforces profit as the primary objective of companies.
  - B. recognises the legal and non-legal obligations of a company to all stakeholders with a legitimate interest in the company.
  - C. is mandatory in Australia.
  - D. is where a result is produced for financial, social and environmental benefit.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

21. Arguments in favour of triple bottom line reporting include:
- A. enhanced all-round company credibility from greater transparency.
  - B. that it facilitates the implementation of an environmental strategy.
  - C. enhanced communication with stakeholders.
  - D. all of the above.

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

22. The Global Reporting Initiative:
- A. refers to an institution based in Sweden.
  - B. is the most widely cited benchmark for the determination of the content of a triple bottom line report.
  - C. was established as a private, profit-making initiative.
  - D. is a set of reporting obligations agreed as part of the Kyoto agreement.

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

23. Which of the following would not form part of social reporting under the GRI 3?
- A. Number of female employees.
  - B. Number of Indigenous employees.
  - C. Donations to charities.
  - D. Greenhouse gas emissions.

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

24. Which of the following would not be part of environmental reporting under the GRI 3?
- A. Greenhouse gas emissions

- B. Amount of recycled paper
- C. Child labour
- D. Biodiversity management

ANS: C                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

25. Which of the following reports are not reports specifically on sustainability issues?
- A. Sustainability report
  - B. Annual report
  - C. Triple bottom line report
  - D. Stakeholder impact report

ANS: B                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

26. Which of the following disclosures would you expect to be included by a company in a triple bottom line report?
- A. Greenhouse gas emissions
  - B. Donations to charities
  - C. Percentage of female staff in senior management positions
  - D. All of the above

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Integrated reporting.

27. Accounting firms generally provide the following services:
- A. Audit and assurance, insolvency and taxation
  - B. Audit, budgeting and management consulting
  - C. Audit, budgeting and cost accounting
  - D. Internal audit, budgeting and management consulting

ANS: A                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Careers in accounting.

28. Managers may select accounting policies for which of the following reasons?
- A. To provide useful information to users
  - B. To avoid violating debt contracts
  - C. To influence compensation plans
  - D. All of the above are correct

ANS: D                      PTS: 1                      AACSB:                      Knowledge, Analytical  
TOP: Economic consequences of accounting information.

## SHORT ANSWER

1. What is the role of accounting information in business?

ANS:

Accounting information helps decision makers. It aids managers by providing quantitative information about the entity to help them in planning, operating and evaluating the entity's activities. Accounting information helps external decision makers by providing them with financial statements containing economic information about the performance and financial position of the entity.

PTS: 1 AACSB: Knowledge, Communication TOP: For what purpose is accounting information used?

2. Distinguish managerial accounting from financial accounting. Your answer should include a brief discussion of differences in the types of information provided to users as well as differences in the identity of users of financial and managerial accounting information.

ANS:

*Financial accounting* is used primarily by external users such as shareholders and creditors and by senior management as a means of evaluating performance. Financial accounting is presented in summary form and must follow generally accepted accounting principles (GAAP). GAAP ensures that information is consistent from period to period and comparable across entities.

*Managerial accounting* is used internally by senior management, functional and division managers and middle managers. Managerial accounting information is frequently presented with detailed information for day-to-day decisions. The information provided does not have to conform to GAAP or need not be consistent between periods or comparable across entities. Rather, it focuses on the information needs of managers. It is critical that managerial accounting information be provided in a timely manner.

PTS: 1 AACSB: Knowledge, Communication TOP: For what purpose is accounting information used?

## PROBLEM

1. Doug Murphy, a newly hired accountant, wanted to impress his boss, so he stayed late one night to analyse the office supplies expense. He determined the cost by month, for the past 12 months, of each of the following: computer paper, copy paper, fax paper, pencils and pens, note pads, postage, corrections supplies, stationery, and miscellaneous items. Why do entities, such as companies, not include information of this nature in published (general purpose) financial statements?

ANS:

Entities provide information to external users to make decisions. The primary decision makers external to the business are creditors, bankers, analysts, shareholders, and potential shareholders. These users need to know that the company can repay its debts, earn a profit, and pay dividends. The cost by month for each item of office supplies does not provide any additional information that would be helpful for any external users. In addition, the time and expense necessary to create the additional detail would outweigh the benefits of the final product.

PTS: 1 AACSB: Knowledge, Communication, Analytical TOP: For what purpose is accounting information used?

## CASE

1. In October 2002, Duke Power, the regulated electricity utility of the United States (US) corporation Duke Energy, agreed to pay \$25 million to its customers to settle allegations by regulators in North and South Carolina that it had underreported net earnings by about \$123 million between 1998 and 2002. The underreporting of net earnings by Duke Energy was allegedly undertaken in order to avoid having to cut its electricity rates.

Required:



Explain what is meant by the term 'economic consequences' and relate this to the underreporting of net earnings by Duke Energy.

ANS:

Economic consequences: wealth effects, resulting from accounting policy choices, impacting, for example, managers, the firm, shareholders and/or debt holders.

Given Duke Energy's status as a regulated electricity utility, and the explanation for the underreporting, from an economic consequences perspective the entity's choice of accounting policies lies with political costs ( p 17).

Further, ultimately if large companies attract lower political costs its managers will be rewarded (p. 17).

PTS: 1                    AACSB:                    Knowledge, Communication, Analytical

TOP: Economic consequences of accounting information.