

# **Test Bank**

to accompany

# **Accounting Theory**

**7th edition**

**PREPARED BY**

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**CHAPTER 2**

**Accounting theory construction**



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## **Chapter 2: Accounting theory construction**

### **True/False**

1. The descriptive pragmatic approach to accounting theory construction is a deductive approach as it is based upon continual observation of accountants in order to copy their accounting procedures and principles.

- a. True
- \*b. False

Feedback: It is an inductive approach not deductive, i.e. it must be tested by reference to empirical evidence, i.e. do accountants, in fact, act in the way the theory suggests.  
Section "Pragmatic theories"

2. The psychological pragmatic approach differs from the descriptive pragmatic approach in that under the psychological approach, the users' response to accounting information is observed rather than the accountants' behaviour.

- \*a. True
- b. False

Feedback: Section "Pragmatic theories"

3. Normative theory researchers in the 1950s and 1960s concentrated on deriving a single measure for assets and a correct profit figure, even though there was no agreement on what constituted a correct or true measure of value and profit.

- \*a. True
- b. False

Feedback: Normative theorist in this period concentrated either on deriving the true profit for an accounting period or on discussing the type of accounting information which would be useful in making economic decisions.  
Section "Normative theories"

4. The concept of realism under the decision-usefulness approach asserts that for an accounting theory to be valid it must hold as a description of the reality that underlies the accounting phenomena.

- \*a. True
- b. False

Feedback: Under the realism approach, an accounting theory is only valid when it serves as more than an instrument for forecasting, that is, it must give relevant feedback or be descriptive of what has occurred in reality.

Section "Normative theories"

5. Positive and normative theories are mutually exclusive; it is not possible for the theories to complement each other.

- a. True
- \*b. False

Feedback: While normative and positive theorists may dismiss each other's viewpoints, it is reasonable to argue that positive accounting theory can be used as a basis for developing accounting practice using normative theories. Section "Positive theories"

6. The main difference between normative and positive theories is that normative theories are descriptive whereas positive theories are prescriptive.

- a. True
- \*b. False

Feedback: It is the other way around. Normative theories are prescriptive because they prescribe what ought to be done, whereas positive theories are descriptive because they describe how people behave and explain why they behave in a certain manner.

Section "Normative theories"

7. The naturalistic approach to theory development looks at specific situations to understand what is happening in that particular situation - generalisability is not an underlying concern.

- \*a. True
- b. False

Feedback: The naturalistic approach is intended to answer the question "What is going on here?" not to provide generalisable conditions for wide segments of society.

Section "Different perspectives"

8. Under the naturalistic approach to research an appropriate research methodology is case studies.

- \*a. True
- b. False

Feedback: The usual way to undertake naturalistic research is to use individual case studies and detailed fieldwork.

Section "Different perspectives"

9. Results from naturalistic research may be more difficult to generalise compared to results from scientific research.

- \*a. True
- b. False

Feedback: Naturalistic research aims at solving individual problems which may be firm- specific, and therefore, the results may be more difficult to generalise.

Section "Different perspectives"

10. Under the Morgan and Smircich classification, Category 1 assumes that the world is unstable and that individuals do not share a common understanding of how the world works.

- a. True
- \*b. False

Feedback: Category 1 assumes that individuals' behaviours will always conform to a set of behavioural rules and therefore their actions are highly predictable and stable. The description given is of Category 6.

Section "Different perspectives"

11. Applying a scientific approach to accounting is an attempt to make scientists out of accounting practitioners.

- a. True
- \*b. False

Feedback: Scientists (i.e. accounting researchers) and accounting practitioners have different roles that can complement each other. Accounting researchers use a scientific approach to find empirical evidence to support accounting practices, so that accounting practitioners can recommend the appropriate methods for given situations based on this evidence.

Section "Scientific approach applied to accounting"

12. Mautz and Sharaf, in 1961, attempted to generalise the existing auditing literature and provide a comprehensive theory of auditing.

- \*a. True
- b. False

Feedback: Mautz and Sharaf, in 1961, attempted to generalise the existing auditing literature and provide a comprehensive theory of auditing.

Section "Issues for auditing theory construction."

13. Recent experimental auditing research has found a negative link between the size of audit firms and the quality of audits performed, i.e. the larger the firm the poorer the audit.

- a. True
  - \*b. False
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Feedback: Recent experimental auditing research has found a *positive* link between the size of audit firms and the quality of audits performed, i.e. larger audit firms have 'more to lose' by failing to report a discovered breach in a client's records.

Section "Issues for auditing theory construction."

## **Multiple choice**

14. Which of these is not a criticism of the descriptive pragmatic approach to theory construction?

- a. It does not allow for accounting techniques to be challenged
- \*b. Some of the users of accounting information may be illogical in their responses
- c. The focus is on the accountant's behaviour not on measuring the attributes of the firm
- d. There is no assessment of whether the accountant reports in the way he or she should

Feedback: This criticism has been applied to the psychological pragmatic approach to theory construction.

Section "Pragmatic theories"

15. Concentrating on decision theories and testing them on large samples of people overcomes a major criticism of which of the following approaches to accounting theory construction?

- a. The positive approach
- \*b. The psychological pragmatic approach
- c. The naturalistic approach
- d. The descriptive pragmatic approach

Feedback: This method can overcome the problem of users reacting in an illogical manner, having preconditioned responses, or not reacting when they should.

Section "Pragmatic theories"

16. Which of these statements is a criticism levelled at syntactic and semantic accounting theories?

- \*a. There will be a great number of accounting techniques which are different but still acceptable under general accounting principles of practice
- b. The assumptions underlying the theories were rarely subjected to empirical testing
- c. The theories developed are not prescriptive, that is they do not guide accounting practice
- d. It does include an analytical judgement of the quality of an accountant's actions

Feedback: The other criticisms have been levelled at the other theory construction approaches described in the chapter.

Section "Syntactic and semantic theories"

17. Which of these is not an assumption used in normative theory construction?

- a. Financial accounting is useful for making economic decisions
- \*b. There are multiple available profit measures
- c. Markets are inefficient and can be fooled by 'creative accountants'
- d. All of the above are not assumptions used in normative theory construction

Feedback: In fact, the assumption is that there is one unique profit measure.  
Section "Normative theories"

18. The criticism of traditional historical cost accounting that is based on a Popperian approach to science is:

- a. Accounting reports prepared using traditional historical cost accounting may have perfect syntax but little value in practice
- b. The existence of accounting doublethink
- \*c. Many of the propositions of historical cost accounting are not falsifiable
- d. All of the above

Feedback: Under the Popperian approach, all hypotheses must be capable of falsification. Many propositions of historical cost accounting, such as the definition of depreciation, are criticised because they are not falsifiable. A and B are incorrect because they are Chambers' criticisms of historical cost accounting.  
Section "Syntactic and semantic theories"

19. The research question that is most unlikely to be tested using positive methodology is:

- a. Which firms are more likely to use straight-line depreciation rather than diminishing-balance depreciation?
- b. How do changes in tax rules affect firm's leverage position?
- c. Are firms with more intangible assets more likely to repurchase their shares?
- \*d. Is the quantitative data derived from given sets of operations based on an overall accounting theory, useful to users of financial statements?

Feedback: A, B, and C are examples of research questions covered by positive accounting theory because they attempt to explain and describe the reasons for current accounting practices. D is a typical question under normative theory (decision-usefulness approach) as it concerns the usefulness of accounting data.  
Section "Normative theories"

20. The statement that is false is:

- a. Normative theories rely on both semantic and syntactic approaches
- b. Questionnaires are often used by positive theorists to test accounting hypotheses
- \*c. Naturalistic research starts with an accepted theory and when an anomaly occurs a new theory is developed to explain it
- d. Normative theorists hold the assumptions that accounting should be a measurement system and that there is only one unique profit measure

Feedback: Statements A, B, and D are true. C is false as naturalistic research starts with real-world situations which may be firm-specific. The research structure described in Statement C is the scientific approach of theory formulation.

Section "Different perspectives"

21. Which of these is not a criticism of the historical cost accounting theoretical model?

- a. There is no independent, empirical operation to verify the calculated outputs such as 'profit' or 'assets'
- b. Poor syntax whereby different types of monetary measures are added together
- c. Many hypotheses associated with the model are unable to be tested as per the falsificationist approach
- \*d. All are criticisms

Feedback: See discussion pages

Section "Syntactic and semantic theories".

22. The statement that is not descriptive of positive theories is:

- a. They are descriptive rather than prescriptive
- b. They avoid making value-laden judgements
- c. They explain why people behave in a certain manner
- \*d. They are concerned with developing policy recommendations for accounting practice

Feedback: This statement is descriptive of normative accounting theories not positive theories.

Section "Positive theories"

23. Which of these is not a typical approach to testing hypotheses under positive accounting theory?

- a. Questionnaires
- b. Surveys
- \*c. Taking output data of specific accounting systems to determine whether the data helps users to make the right decisions
- d. Testing the assumed importance of accounting outputs in the marketplace

Feedback: A, B, and D are the typical methods used to test hypotheses under positive accounting theory. C is an approach used in normative theory especially under the decision-usefulness approach.

Section "Positive theories"

24. A comparison of scientific and naturalistic research

	Scientific Research	Naturalistic Research
1	2  • Accounting is objective reality	• Reality is socially constructed and a product of human imagination  3
4	5  • Reductionism  • Testing of individual hypotheses  • Laws capable of generalisation	• Holistic 6  • Irreducible laws
Methodology	7  • Prior theoretical base  • Empirical validation of extension	• Unstructured 8
Methods	9  • Empirical induction to form hypotheses  • Appropriate statistical methods	• Case studies 10  • Experience of events

Which word/phrase should be inserted in position 9 in the table above?

- \*a. Syntactic model formulation
- b. Exploration by flexibility
- c. No prior theory
- d. d. Piecemeal advancement of knowledge

Feedback: See Table 2.2 on page 32 of the text.  
Section "Different perspectives".

25. A comparison of scientific and naturalistic research

Scientific Research			Naturalistic Research		
1	2	3	4	5	6
	<ul style="list-style-type: none"> <li>Accounting is objective reality</li> </ul>	<ul style="list-style-type: none"> <li>Reality is socially constructed and a product of human imagination</li> </ul>		<ul style="list-style-type: none"> <li>Reductionism</li> <li>Testing of individual hypotheses</li> <li>Laws capable of generalisation</li> </ul>	<ul style="list-style-type: none"> <li>Holistic</li> <li>Irreducible laws</li> </ul>
Methodology	7	8		<ul style="list-style-type: none"> <li>Prior theoretical base</li> <li>Empirical validation of extension</li> </ul>	<ul style="list-style-type: none"> <li>Unstructured</li> </ul>
Methods	9	10		<ul style="list-style-type: none"> <li>Empirical induction to form hypotheses</li> <li>Appropriate statistical methods</li> </ul>	<ul style="list-style-type: none"> <li>Case studies</li> <li>Experience of events</li> </ul>

Which word/phrase should be inserted in position 5 in the table above?

- a. Exploration by flexibility
- \*b. Piecemeal advancement of knowledge
- c. Reality is objective and concrete
- d. Ontological Assumptions

Feedback: See Table 2.2 on page 32 of the text.  
Section "Different perspectives".

26. A comparison of scientific and naturalistic research

	Scientific Research	Naturalistic Research
1	2	<ul style="list-style-type: none"> <li>• Reality is socially constructed and a product of human imagination</li> </ul> <p>3</p>
4	5	<ul style="list-style-type: none"> <li>• Holistic</li> </ul> <p>6</p> <ul style="list-style-type: none"> <li>• Irreducible laws</li> </ul>
Methodology	7	<ul style="list-style-type: none"> <li>• Unstructured</li> </ul> <p>8</p>
Methods	9	<ul style="list-style-type: none"> <li>• Case studies</li> </ul> <p>10</p> <ul style="list-style-type: none"> <li>• Experience of events</li> </ul>
	<ul style="list-style-type: none"> <li>• Accounting is objective reality</li> </ul>	
	<ul style="list-style-type: none"> <li>• Reductionism</li> <li>• Testing of individual hypotheses</li> <li>• Laws capable of generalisation</li> </ul>	
	<ul style="list-style-type: none"> <li>• Prior theoretical base</li> <li>• Empirical validation of extension</li> </ul>	
	<ul style="list-style-type: none"> <li>• Empirical induction to form hypotheses</li> <li>• Appropriate statistical methods</li> </ul>	

Which word/phrase should be inserted in position 3 in the table above?

- a. Exploration by flexibility
- b. Piecemeal advancement of knowledge
- c. Reality is objective and concrete
- \*d. Accounting is constructed reality

Feedback: See Table 2.2 on page 32 of the text.  
Section "Different perspectives".

27. A comparison of scientific and naturalistic research

	Scientific Research	Naturalistic Research
1	2	<ul style="list-style-type: none"> <li>• Reality is socially constructed and a product of human imagination</li> </ul> <p>3</p>
4	5	<ul style="list-style-type: none"> <li>• Holistic</li> </ul> <p>6</p> <ul style="list-style-type: none"> <li>• Irreducible laws</li> </ul>
Methodology	7	<ul style="list-style-type: none"> <li>• Unstructured</li> </ul> <p>8</p>
Methods	9	<ul style="list-style-type: none"> <li>• Case studies</li> </ul> <p>10</p> <ul style="list-style-type: none"> <li>• Experience of events</li> </ul>
	<ul style="list-style-type: none"> <li>• Accounting is objective reality</li> </ul>	
	<ul style="list-style-type: none"> <li>• Reductionism</li> <li>• Testing of individual hypotheses</li> <li>• Laws capable of generalisation</li> </ul>	
	<ul style="list-style-type: none"> <li>• Prior theoretical base</li> <li>• Empirical validation of extension</li> </ul>	
	<ul style="list-style-type: none"> <li>• Empirical induction to form hypotheses</li> <li>• Appropriate statistical methods</li> </ul>	

Which word/phrase should be inserted in position 10 in the table above?

- \*a. Exploration by flexibility
- b. Piecemeal advancement of knowledge
- c. Reality is objective and concrete
- d. Accounting is constructed reality

Feedback: See Table 2.2 on page 32 of the text.  
Section "Different perspectives".

28. A comparison of scientific and naturalistic research

	Scientific Research	Naturalistic Research
1	2	<ul style="list-style-type: none"> <li>• Reality is socially constructed and a product of human imagination</li> </ul> <p>3</p>
4	5	<ul style="list-style-type: none"> <li>• Holistic</li> </ul> <p>6</p> <ul style="list-style-type: none"> <li>• Irreducible laws</li> </ul>
Methodology	7	<ul style="list-style-type: none"> <li>• Unstructured</li> </ul> <p>8</p>
Methods	9	<ul style="list-style-type: none"> <li>• Case studies</li> </ul> <p>10</p> <ul style="list-style-type: none"> <li>• Experience of events</li> </ul>
	<ul style="list-style-type: none"> <li>• Accounting is objective reality</li> </ul>	
	<ul style="list-style-type: none"> <li>• Reductionism</li> <li>• Testing of individual hypotheses</li> <li>• Laws capable of generalisation</li> </ul>	
	<ul style="list-style-type: none"> <li>• Prior theoretical base</li> <li>• Empirical validation of extension</li> </ul>	
	<ul style="list-style-type: none"> <li>• Empirical induction to form hypotheses</li> <li>• Appropriate statistical methods</li> </ul>	

Which word/phrase should be inserted in position 2 in the table above?

- a. Exploration by flexibility
- b. Piecemeal advancement of knowledge
- \*c. Reality is objective and concrete
- d. Accounting is constructed reality

Feedback: See Table 2.2 on page 32 of the text.  
Section "Different perspectives".

29. Which of these arguments describes the symbolic interactionists' view?

- a. Behaviour will always conform to a set of behavioural rules
- \*b. People form their own separate impressions through a process of human interaction and negotiation
- c. Reality is a concrete structure
- d. Outcomes of decisions and actions are highly predictable

Feedback: Symbolic interactionist is the term used for category 4-6 in Morgan and Smircich's classification of ontological assumption sets (Table 2.1). The symbolic interactionists believe that reality is embodied in the meanings that result from people's interpretation of the situations and events they experience.  
Section "Different perspectives".

30. Which of these arguments is not a criticism of scientific method?

- \*a. Results from scientific-based research are difficult to generalise
- b. Hypotheses are based on the use of share market prices or surveys which are remote from the world of practitioners
- c. Large-scale statistical research tends to lump everything together
- d. Hypotheses are not commensurate with the concerns of many individual accountants

Feedback: B, C and D are criticisms of scientific method. A is a criticism of the naturalistic approach.  
Section "Different perspectives".

31. The following research methods are used by naturalistic researchers, except:

- a. Case studies
- b. Experience of events
- \*c. Syntactic model formulation
- d. Exploration by flexibility

Feedback: A, B, and D are methods used in naturalistic research, whereas C is used in scientific research. (Refer to Table 2.2).  
Section "Different perspectives".

32. Which of these is the epistemology of naturalistic research?

- a. Reductionism
- b. Laws capable of generalisation
- \*c. Holistic
- d. Testing of individual hypotheses

Feedback: Refer to Table 2.2.  
Section "Different perspectives".

33. The statement concerning Mautz and Sharaf's work on auditing theory in the 1960's that is not correct is:

- a. They attempted to provide a comprehensive theory of auditing
- \*b. They believed that in essence auditing was a practical exercise
- c. They developed eight postulates as a foundation for the theory of auditing
- d. The concepts they developed are embedded in current auditing standards

Feedback: A, C and D are correct statements, B. is incorrect. Mautz and Sharaf, in their work, were attempting to *counter* the view then prevalent, that audit was a practical subject without any professional underpinnings.  
Section "Issues for auditing theory construction".

## **Essay Questions**

34. Explain and discuss the criticisms of historical cost accounting for poor syntax and semantic deficiencies. In your discussion refer to counter arguments that have been raised in defence of these criticisms.

35. "The main difference between normative and positive (accounting) theories is that normative theories are prescriptive, whereas positive theories are descriptive, explanatory or predictive". J. Godfrey, et al, 'Accounting Theory', 7<sup>th</sup> Ed. p.29. Explain and discuss the quotation. Include in your answer an opinion as to whether the two approaches are compatible or incompatible.

36. "Most researchers now accept that the most appropriate approach depends on the nature of the research question being considered". J. Godfrey, et al, 'Accounting Theory', 7<sup>th</sup> Ed. p.5. p. 30. Compare the scientific method with the naturalistic approach to accounting research.

37. The scientific approach to accounting research assumes there is an absolute truth that accounting should achieve and that accounting practitioners should become scientists' Explain why both parts of this statement are misconceptions.

38. Briefly outline developments in auditing theory associated with i. the normative era, and, ii. the positive era.