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CHAPTER 2

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

IFRS questions are available at the end of this chapter.

TRUE-FALSE—Conceptual

Answer	No.	Description
T	1.	Nature of conceptual framework.
T	2.	Conceptual framework definition.
F	3.	Levels of conceptual framework.
T	4	International conceptual framework.
F	5.	Statements of Financial Accounting Concepts.
T	6.	Objective of financial reporting.
F	7.	Financial statement users.
T	8.	Relevance and faithful representation.
T	9.	Consistency.
F	10.	Relevance.
F	11.	Faithful representation.
F	12.	Basic elements.
T	13.	Comprehensive income.
T	14.	Going concern assumption.
F	15.	Economic entity assumption.
F	16.	Expense recognition principle.
T	17.	Recognizable revenues.
T	18.	Supplementary information.
F	19.	Cost benefit trade-off.
F	20.	Cost-benefit relationship.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
c	21.	GAAP defined.
d	22.	Purpose of conceptual framework.
c	23.	Conceptual framework.
d	24.	Conceptual framework purpose.
d	25.	Conceptual framework benefits.
d	26.	Objectives of financial reporting.
a	27.	Decision usefulness.
d	28.	General purpose of financial reporting.
a	29.	Primary objective of financial reporting.
a	30.	Example of consistency.
a	31.	Primary quality of relevance.
b	32.	Characteristic of accounting information.
c	33.	Characteristic of accounting information.
c	34.	Meaning of comparability.
a	35.	Meaning of consistency.

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MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
d	36.	Ingredient of relevance.
c	37.	Ingredient of faithful representation.
a	38.	Consistency characteristic.
b	39.	Enhancing quality of accounting information.
d	40.	Quality of relevance.
a	41.	Quality of faithful representation.
d	42.	Consistency quality.
a	43.	Decision-usefulness criterion.
c	44.	Fundamental qualities of accounting information.
b	45.	Definition of relevance.
b	46.	Definition of faithful representation.
d	47.	Relevance quality.
c	48.	Materiality characteristic.
d	49.	Completeness characteristic.
b	50.	Neutrality characteristic.
d	51.	Neutrality characteristic.
c	52.	Definition of verifiability.
a	53.	Quality of predictive value.
c	54.	Quality of free from error.
d	55.	Consistency characteristic.
b	56.	Consistency characteristic.
b	57.	Comparability and consistency.
d	58.	Comparability.
d	59.	Elements of financial statements.
c	60.	Distinction between revenues and gains.
c	61.	Definition of a loss.
d	62.	Definition of comprehensive income.
b	63.	Components of comprehensive income.
d	64.	Comprehensive income.
b	65.	Definition of exposure.
a	66.	Reporting financial statement elements.
b	67	Basic element of financial statements.
a	68.	Basic element of financial statements.
d	69.	Basic element of financial statements.
c	70.	Definition of gains.
d	71.	Historical cost assumption.
c	72.	Periodicity assumption.
b	73	Going concern assumption.
b	74.	Periodicity assumption.
a	75.	Monetary unit assumption.
c	76.	Periodicity assumption.
c	77.	Monetary unit assumption.
d	78.	Economic entity assumption.
a	79.	Economic entity assumption.
b	80.	Periodicity assumption.
a	81.	Going concern assumption.
d	82.	Going concern assumption.
d	83.	Implications of going concern assumption.
a	84.	Historical cost principle.

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MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
d	85.	Historical cost principle.
c	86.	Revenue recognition principle.
d	87.	Revenue recognition principle.
d	88.	Revenue recognition principle.
d	89.	Measurement principle.
c	90.	Expense recognition principle.
b	91.	Product costs.
b	92.	Expense recognition principle.
b	93.	Expense recognition principle.
b	94.	Expense recognition.
c	95.	Full-disclosure principle.
a	96.	Argument against historical cost.
d	97.	Recognition of revenue.
b	98.	Revenue recognition principle.
c	99.	Definition of performance obligation.
a	100.	Required components of financial statements.
d	101.	Recognition of expenses.
c	102.	Monetary unit principle.
a	103.	Expense recognition principle example.
d	104.	Recording expenditure as asset.
c	105.	Historical cost principle violation.
a	106.	Full disclosure principle violation.
d	107.	Full disclosure principle.
c	108.	Historical cost principle violation.
a	109.	Cost constraint.
c	110.	Costs of providing financial information.
d	111.	Benefits of providing financial information.
c	112.	Use of materiality.
b	113.	Definition of prudence/conservation.
a	114.	Example of materiality constraint.
d	115.	Cost-benefit relationship.
a	116.	Cost-benefit relationship.
c	117.	Materiality characteristic.
d	118.	Materiality.
d	119.	Pervasive constraints.
a	120.	Cost constraint.
b	121.	Conceptual framework second level
a	122.	Trade-offs between characteristics of accounting information.
c	123.	Trade-offs between characteristics of accounting information.
c	124.	Conceptual framework third level.

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MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
a	125.	Quality of predictive value.
b	126.	Relevance and faithful representation.
b	127.	Classification of gains and losses.
b	128.	Comparability quality.
a	129.	Elements of financial statements.
b	130.	Components of comprehensive income.
d	131.	Faithful representation concept.
d	132.	Essential characteristic of an asset.
a	133.	Definition of rational and systematic allocation.

BRIEF EXERCISES

Item	Description
BE2-134	Qualitative characteristics.
BE2-135	Accounting concepts—identification.
BE2-136	Accounting concepts—identification.

EXERCISES

Item	Description
E2-137	Accounting concepts—matching.
E2-138	Accounting concepts—fill in the blanks.
E2-139	Basic assumptions.
E2-140	Historical cost principle.
E2-141	Expense recognition concept.

CHAPTER LEARNING OBJECTIVES

1. Describe the usefulness of a conceptual framework and the objective of financial reporting.

2. Identify the qualitative characteristics of accounting information and the basic elements of financial statements.

3. Review the basic assumptions of accounting.

4. Explain the application of the basic principles of accounting.

*5. Compare the conceptual frameworks underlying GAAP and IFRS.

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SUMMARY OF QUESTIONS BY LEARNING OBJECTIVES AND BLOOM'S TAXONOMY

Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT	Item	LO	BT
TRUE-FALSE STATEMENTS														
1.	1	K	5.	1	K	9.	2	C	13.	2	K	17.	4	K
2.	1	K	6.	1	K	10.	2	K	14.	3	C	18.	4	K
3.	1	K	7.	1	K	11.	2	K	15.	3	K	19.	4	C
4.	1	K	8.	2	K	12.	2	C	16.	4	K	20.	4	C
MULTIPLE CHOICE QUESTIONS														
21.	1	K	44.	2	K	67.	2	K	90.	4	K	113.	4	K
22.	1	K	45.	2	K	68.	2	K	91.	4	C	114.	4	C
23.	1	K	46.	2	K	69.	2	C	92.	4	C	115.	4	C
24.	1	K	47.	2	K	70.	2	K	93.	4	C	116.	4	C
25.	1	C	48.	2	K	71.	3	K	94.	4	C	117.	4	C
26.	1	C	49.	2	K	72.	3	C	95.	4	C	118.	4	C
27.	1	K	50.	2	K	73.	3	C	96.	4	C	119.	4	K
28.	1	C	51.	2	K	74.	3	C	97.	4	K	120.	4	K
29.	1	C	52.	2	K	75.	3	C	98.	4	C	121.	4	K
30.	2	K	53.	2	K	76.	3	K	99.	4	C	122.	4	C
31.	2	K	54.	2	K	77.	3	K	100.	4	K	123.	4	C
32.	2	K	55.	2	C	78.	3	K	101.	4	K	124.	4	C
33.	2	K	56.	2	C	79.	3	C	102.	4	C	125.	2	K
34.	2	C	57.	2	K	80.	3	C	103.	4	C	126.	2	K
35.	2	C	58.	2	K	81.	3	C	104.	4	K	127.	2	K
36.	2	K	59.	2	K	82.	3	K	105.	4	C	128.	2	K
37.	2	K	60.	2	K	83.	3	C	106.	4	C	129.	2	K
38.	2	C	61.	2	K	84.	4	C	107.	4	C	130.	2	K
39.	2	C	62.	2	K	85.	4	C	108.	4	C	131.	2	K
40.	2	K	63.	2	K	86.	4	C	109.	4	K	132.	2	K
41.	2	K	64.	2	C	87.	4	C	110.	4	K	133.	4	K
42.	2	C	65.	2	K	88.	4	K	111.	4	C			
43.	2	C	66.	2	K	89.	4	K	112.	4	C			
BRIEF EXERCISES														
134.	1	C	135.	2, 3, 4, 4	C	136.	2, 4, 4	C						
EXERCISES														
137.	2, 4	K	138.	2, 3, 4	K	139.	3	K	140.	3, 4	AN	141.	4	C

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TRUE-FALSE—Conceptual

1. A soundly developed conceptual framework enables the FASB to issue more useful and consistent pronouncements over time.

Ans: T, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

2. A conceptual framework is a coherent system of concepts that flow from an objective.

Ans: T, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

3. The first level of the conceptual framework identifies the recognition, measurement, and disclosure concepts used in establishing accounting standards.

Ans: F, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

4. The second level of the conceptual framework provides the qualitative characteristics that make accounting information useful and the elements of financial statements.

Ans: T, LO: 1, Bloom: K, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

5. Although the FASB has developed a conceptual framework, no Statements of Financial Accounting Concepts have been issued to date.

Ans: F, LO: 1, Bloom: K, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

6. The objective of financial reporting is the foundation of the conceptual framework.

Ans: T, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

7. Users of financial statements are assumed to need **no** knowledge of business and financial accounting matters to understand information contained in financial statements.

Ans: F, LO: 1, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

8. Relevance and faithful representation are the two fundamental qualities that make accounting information useful for decision making.

Ans: T, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

9. The idea of consistency does **not** mean that companies cannot switch from one accounting method to another.

Ans: T, LO: 2, Bloom: C, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

10. Timeliness and neutrality are two ingredients of relevance.

Ans: F, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

11. Verifiability and predictive value are two ingredients of faithful representation.

Ans: F, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

12. Revenues, gains, and distributions to owners all increase equity.

Ans: F, LO: 2, Bloom: C, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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13. Comprehensive income includes all changes in equity during a period **except** those resulting from investments by owners and distributions to owners.

Ans: T, LO: 2, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

14. The historical cost principle would be of limited usefulness if **not** for the going concern assumption.

Ans: T, LO: 3, Bloom: C, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

15. The economic entity assumption means that economic activity can be identified with a particular legal entity.

Ans: F, LO: 3, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

16. The expense recognition principle states that debits must equal credits in each transaction.

Ans: F, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

17. Revenues are recognized in the accounting period in which the performance obligation is satisfied.

Ans: T, LO: 4, Bloom: K, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

18. Supplementary information may include details or amounts that present a different perspective from that adopted in the financial statements.

Ans: T, LO: 4, Bloom: K, Difficulty: Easy, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

19. In order to justify requiring a particular measurement or disclosure, the benefits to be derived from it must equal the costs associated with it.

Ans: F, LO: 4, Bloom: C, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

20. In cost-benefit analysis, costs are generally more difficult to quantify than are benefits.

Ans: F, LO: 4, Bloom: C, Difficulty: Moderate, Min: 1, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

True False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	6.	T	11.	F	16.	F
2.	T	7.	F	12.	F	17.	T
3.	F	8.	T	13.	T	18.	T
4.	T	9.	T	14.	T	19.	F
5.	F	10.	F	15.	F	20.	F

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MULTIPLE CHOICE—Conceptual

21. Generally accepted accounting principles
    a. are fundamental truths or axioms that can be derived from laws of nature.
    b. derive their authority from legal court proceedings.
    c. derive their credibility and authority from general recognition and acceptance by the accounting profession.
    d. have been specified in detail in the FASB conceptual framework.

Ans: c, LO: 1, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

22. A soundly developed conceptual framework of concepts and objectives should
    a. increase financial statement users' understanding of and confidence in financial reporting.
    b. enhance comparability among companies' financial statements.
    c. allow new and emerging practical problems to be more quickly solved.
    d. All of these answer choices are correct.

Ans: d, LO: 1, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

23. Which of the following is **not** true concerning a conceptual framework in accounting?
    a. It should be a basis for standard-setting.
    b. It should allow practical problems to be solved more quickly by reference to it.
    c. It should be based on fundamental truths that are derived from the laws of nature.
    d. All of these answer choices are true.

Ans: c, LO: 1, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

24. What is a purpose of having a conceptual framework?
    a. To make sure that economic activity can be identified with a particular legal entity.
    b. To segregate activities among different companies.
    c. To provide comparable information for different companies.
    d. To enable the profession to more quickly solve emerging practical problems and to provide a foundation from which to build more useful standards.

Ans: d, LO: 1, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

[S]25. Which of the following is **not** a benefit associated with the FASB Conceptual Framework Project?
    a. A conceptual framework should increase financial statement users' understanding of and confidence in financial reporting.
    b. Practical problems should be more quickly solvable by reference to an existing conceptual framework.
    c. A coherent set of accounting standards and rules should result.
    d. Business entities will need far less assistance from accountants because the financial reporting process will be quite easy to apply.

Ans: d, LO: 1, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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26. In the conceptual framework for financial reporting, what provides "the why"--the purpose of accounting?
    a. Recognition, measurement, and disclosure concepts such as assumptions, principles, and constraints
    b. Qualitative characteristics of accounting information
    c. Elements of financial statements
    d. Objective of financial reporting

Ans: d, LO: 1, Bloom: C, Difficulty: Medium, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

27. The underlying theme of the conceptual framework is
    a. decision usefulness.
    b. understandability.
    c. faithful representation.
    d. comparability.

Ans: a, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

28. The objective of general-purpose financial reporting is to provide financial information about a reporting entity to each of the following **except**
    a. potential equity investors.
    b. potential lenders.
    c. present investors.
    d. All of these answers are correct.

Ans: d, LO: 1, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

29. The objective of general-purpose financial reporting is?
    a. to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers
    b. to provide companies with the option to select information that favors one set of interested parties over another
    c. to provide users with financial information that implies total freedom from error.
    d. to provide a metric for financial information used to determine when the boundary between two or more entities should be disregarded and the entities considered to be a licensing arrangement.

Ans: a, LO: 1, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

[P]30. If the LIFO inventory method was used last period, it should be used for the current and following periods because of
    a. consistency.
    b. materiality.
    c. timeliness.
    d. verifiability.

Ans: a, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

[S]31. Which of the following is a characteristic describing the fundamental quality of relevance?
    a. Predictive value.
    b. Neutrality.
    c. Verifiability.
    d. Understandability.

Ans: a, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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32. Which of the following is a fundamental quality of useful accounting information?
    a. Comparability
    b. Relevance
    c. Neutrality
    d. Materiality

Ans: b, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

33. Which of the following is a fundamental quality of useful accounting information?
    a. Conservatism
    b. Comparability
    c. Faithful representation
    d. Consistency

Ans: c, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

34. What is meant by comparability when discussing financial accounting information?
    a. Information has predictive or confirmatory value.
    b. Information is reasonably free from error.
    c. Information is measured and reported in a similar fashion across companies.
    d. Information is timely.

Ans: c, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

35. What is meant by consistency when discussing financial accounting information?
    a. Information presented by a company applies the same accounting treatment to similar events, from period to period.
    b. Information is timely.
    c. Information is classified, characterized, and presented clearly and concisely.
    d. Information is verifiable.

Ans: a, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

36. Which of the following is an ingredient of relevance?
    a. Completeness
    b. Neutrality
    c. Timeliness
    d. Materiality

Ans: d, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

37. Which of the following is an ingredient of faithful representation?
    a. Predictive value
    b. Materiality
    c. Neutrality
    d. Confirmatory value

Ans: c, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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38. Changing the method of inventory valuation should be reported in the financial statements because of which qualitative characteristic of accounting information?
    a. Consistency
    b. Verifiability
    c. Timeliness
    d. Comparability

Ans: a, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

39. A company issuing its annual financial reports within one month of the end of the year is an example of which enhancing quality of accounting information?
    a. Comparability
    b. Timeliness
    c. Understandability
    d. Verifiability

Ans: b, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

40. What is the quality of information that is capable of making a difference in a decision?
    a. Understandability
    b. Materiality
    c. Timeliness
    d. Relevance

Ans: d, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

41. Neutrality is an ingredient of which fundamental quality of information?
    a. Faithful representation
    b. Comparability
    c. Relevance
    d. Understandability

Ans: a, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

42. If the FIFO inventory method was used last period, it should be used for the current and following periods because of
    a. relevance.
    b. neutrality.
    c. understandability.
    d. consistency.

Ans: d, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

43. The pervasive criterion by which accounting information can be judged is that of
    a. decision usefulness.
    b. freedom from bias.
    c. timeliness.
    d. comparability.

Ans: a, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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44. The two fundamental qualities that make accounting information useful for decision making are
    a. comparability and timeliness.
    b. materiality and neutrality.
    c. relevance and faithful representation.
    d. faithful representation and comparability.

Ans: c, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

45. Accounting information is considered to be relevant when it
    a. can be depended on to represent the economic conditions and events that it is intended to represent.
    b. is capable of making a difference in a decision.
    c. is understandable by reasonably informed users of accounting information.
    d. is verifiable and neutral.

Ans: b, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

46. The quality of information that means the numbers and descriptions match what really existed or happened is
    a. relevance.
    b. faithful representation.
    c. completeness.
    d. neutrality.

Ans: b, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

47. Which of the following does **not** relate to relevance?
    a. Materiality
    b. Predictive value
    c. Confirmatory value
    d. All of these answer choices relate to relevance.

Ans: d, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

48. According to *Statement of Financial Accounting Concepts No. 8,* materiality is an ingredient of the fundamental quality(ies) of:

	Relevance	Faithful Representation
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

Ans: c, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

49. According to *Statement of Financial Accounting Concepts No. 8,* completeness is an ingredient of the fundamental quality(ies) of:

	Relevance	Faithful Representation
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

Ans: d, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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50. According to *Statement of Financial Accounting Concepts No. 8,* neutrality is an ingredient of the fundamental quality(ies) of:

	Relevance	Faithful Representation
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

Ans: b, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

51. Neutrality means that information
    a. provides benefits which are at least equal to the costs of its preparation.
    b. can be compared with similar information about an enterprise at other points in time.
    c. would have no impact on a decision maker.
    d. cannot favor one set of interested parties over another.

Ans: d, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

52. The characteristic that is demonstrated when a high degree of consensus can be secured among independent measurers using the same measurement methods is
    a. relevance.
    b. faithful representation.
    c. verifiability.
    d. neutrality.

Ans: c, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

53. According to *Statement of Financial Accounting Concepts No. 8,* predictive value is an ingredient of the fundamental quality(ies) of:

	Relevance	Faithful Representation
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

Ans: a, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

54. Under *Statement of Financial Accounting Concepts No. 2,* free from error is an ingredient of the fundamental quality of

	Faithful Representation	Relevance
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

Ans: c, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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55. Financial information demonstrates consistency when
    a. firms in the same industry use different accounting methods to account for the same type of transaction.
    b. a company changes its estimate of the salvage value of a fixed asset.
    c. a company fails to adjust its financial statements for changes in the value of the measuring unit.
    d. None of these answer choices are correct.

Ans: d, LO: 2, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

56. Financial information exhibits the characteristic of consistency when
    a. expenses are reported as charges against revenue in the period in which they are paid.
    b. a company applies the same accounting treatment to similar events, from period to period.
    c. extraordinary gains and losses are not included on the income statement.
    d. accounting procedures are adopted which give a consistent rate of net income.

Ans: b, LO: 2, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

57. Information about different companies and about different periods of the same company can be prepared and presented in a similar manner. Comparability and consistency are related to which of these objectives?

	Comparability	Consistency
a.	Companies	Companies
b.	Companies	Periods
c.	Periods	Companies
d.	Periods	Periods

Ans: b, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

58. When information about two different enterprises has been prepared and presented in a similar manner, the information exhibits the characteristic of
    a. relevance.
    b. faithful representation.
    c. consistency.
    d. None of these answer choices are correct.

Ans: d, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

59. The elements of financial statements include investments by owners. These are increases in an entity's net assets resulting from owners'
    a. transfers of assets to the entity.
    b. rendering services to the entity.
    c. satisfaction of liabilities of the entity.
    d. All of these answer choices are correct.

Ans: d, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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60. In classifying the elements of financial statements, the primary distinction between revenues and gains is
    a. the materiality of the amounts involved.
    b. the likelihood that the transactions involved will recur in the future.
    c. the nature of the activities that gave rise to the transactions involved.
    d. the costs versus the benefits of the alternative methods of disclosing the transactions involved.

Ans: c, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

61. A decrease in net assets arising from peripheral or incidental transactions is called a(n)
    a. capital expenditure.
    b. cost.
    c. loss.
    d. expense.

Ans: c, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

62. One of the elements of financial statements is comprehensive income. As described in *Statement of Financial Accounting Concepts No. 6,* "Elements of Financial Statements," comprehensive income is equal to
    a. revenues minus expenses plus gains minus losses.
    b. revenues minus expenses plus gains minus losses plus investments by owners minus distributions to owners.
    c. revenues minus expenses plus gains minus losses plus investments by owners minus distributions to owners plus assets minus liabilities.
    d. None of these answer choices are correct.

Ans: d, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

63. Which of the following elements of financial statements is not a component of comprehensive income?
    a. Revenues
    b. Distributions to owners
    c. Losses
    d. Expenses

Ans: b, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

P64. The calculation of comprehensive income includes which of the following?

	Operating Income	Distributions to Owners
a.	Yes	Yes
b.	No	No
c.	No	Yes
d.	Yes	No

Ans: d, LO: 2, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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S65. According to the FASB conceptual framework, which of the following elements describes transactions or events that affect a company during a period of time?
a. Assets.
b. Expenses.
c. Equity.
d. Liabilities.

Ans: b, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

S66. According to the FASB Conceptual Framework, the elements—assets, liabilities, and equity—describe amounts of resources and claims to resources at/during a

	Moment in Time	Period of Time
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

Ans: a, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

67. Which of the following is **not** a basic element of financial statements?
a. Assets
b. Balance sheet
c. Losses
d. Revenue

Ans: b, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

68. Which of the following basic elements of financial statements is more associated with the balance sheet than the income statement?
a. Equity
b. Revenue
c. Gains
d. Expenses

Ans: a, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

69. Issuance of common stock for cash affects which basic element of financial statements?
a. Revenues
b. Losses
c. Liabilities
d. Equity

Ans: d, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

70. Which of these basic elements of financial statements arises from peripheral or incidental transactions?
a. Assets
b. Liabilities
c. Gains
d. Expenses

Ans: c, LO: 2, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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71. Which of the following is **not** a basic assumption underlying the financial accounting structure?
    a. Economic entity assumption
    b. Going concern assumption
    c. Periodicity assumption
    d. Historical cost assumption

Ans: d, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

72. Which basic assumption is illustrated when a firm reports financial results on an annual basis?
    a. Economic entity assumption
    b. Going concern assumption
    c. Periodicity assumption
    d. Monetary unit assumption

Ans: c, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

73. Which basic assumption may **not** be followed when a firm in bankruptcy reports financial results?
    a. Economic entity assumption
    b. Going concern assumption
    c. Periodicity assumption
    d. Monetary unit assumption

Ans: b, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

74. Which accounting assumption or principle is being violated if a company provides financial reports only when it introduces a new product?
    a. Economic entity
    b. Periodicity
    c. Revenue recognition
    d. Full disclosure

Ans: b, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

[S]75. Which of the following basic accounting assumptions is threatened by the existence of severe inflation in the economy?
    a. Monetary unit assumption
    b. Periodicity assumption
    c. Going-concern assumption
    d. Economic entity assumption

Ans: a, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

[S]76. During the lifetime of an entity accountants produce financial statements at artificial points in time in accordance with the concept of

	Relevance	Periodicity
a.	No	No
b.	Yes	No
c.	No	Yes
d.	Yes	Yes

Ans: c, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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77. Under current GAAP, inflation is ignored in accounting due to the
    a. economic entity assumption.
    b. going concern assumption.
    c. monetary unit assumption.
    d. periodicity assumption.

Ans: c, LO: 3, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

78. The economic entity assumption
    a. is inapplicable to unincorporated businesses.
    b. recognizes the legal aspects of business organizations.
    c. requires periodic income measurement.
    d. is applicable to all forms of business organizations.

Ans: d, LO: 3, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

79. Preparation of consolidated financial statements when a parent-subsidiary relationship exists is an example of the
    a. economic entity assumption.
    b. relevance characteristic.
    c. comparability characteristic.
    d. neutrality characteristic.

Ans: a, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

80. During the lifetime of an entity, accountants produce financial statements at arbitrary points in time in accordance with which basic accounting concept?
    a. Cost constraint
    b. Periodicity assumption
    c. Conservatism
    d. Expense recognition principle

Ans: b, LO: 3, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

81. What accounting concept justifies the usage of depreciation and amortization policies?
    a. Going concern assumption
    b. Fair value principle
    c. Full disclosure principle
    d. Monetary unit assumption

Ans: a, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

82. The assumption that a company will **not** be sold or liquidated in the near future is known as the
    a. economic entity assumption.
    b. monetary unit assumption.
    c. periodicity assumption.
    d. None of these answer choices are correct.

Ans: d, LO: 3, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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83. Which of the following is an implication of the going concern assumption?
    a. The historical cost principle is credible.
    b. Depreciation and amortization policies are justifiable and appropriate.
    c. The current-noncurrent classification of assets and liabilities is justifiable and significant.
    d. All of these.

Ans: d, LO: 3, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

84. Proponents of historical cost ordinarily maintain that in comparison with all other valuation alternatives for general purpose financial reporting, statements prepared using historical costs are more
    a. verifiable.
    b. relevant.
    c. indicative of the entity's purchasing power.
    d. conservative.

Ans: a, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

85. Valuing assets at liquidation values rather than cost is inconsistent with the
    a. periodicity assumption.
    b. expense recognition principle.
    c. materiality constraint.
    d. historical cost principle.

Ans: d, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

86. Revenue is recognized in the accounting period in which the performance obligation is satisfied. This statement describes the
    a. consistency characteristic.
    b. expense recognition principle.
    c. revenue recognition principle.
    d. relevance characteristic.

Ans: c, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

87. Generally, revenue from sales should be recognized at a point when
    a. management decides it is appropriate to do so.
    b. the product is available for sale to the ultimate consumer.
    c. the entire amount receivable has been collected from the customer and there remains no further warranty liability.
    d. None of these answer choices are correct.

Ans: d, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

88. Revenue generally should be recognized
    a. at the end of production.
    b. at the time of cash collection.
    c. when realized.
    d. when the performance obligation is satisfied.

Ans: d, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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89. The measurement principle includes the
    a. fair value principle only.
    b. historical cost principle only.
    c. revenue recognition principle and expense recognition principle.
    d. historical cost principle and the fair value principle.

Ans: d, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

90. Which of the following is commonly referred to as the matching principle?
    a. Revenue recognition principle
    b. Measurement principle
    c. Expense recognition principle
    d. Full disclosure principle

Ans: c, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

91. Product costs include each of the following **except**
    a. overhead.
    b. officer's salaries.
    c. material.
    d. labor.

Ans: b, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

92. Recognizing expenses **not** when a company pays wages, but when the work actually contributes to revenue in in accordance with the
    a. consistency characteristic.
    b. expense recognition principle.
    c. materiality characteristics.
    d. revenue recognition principle.

Ans: b, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

93. The accounting principle of expense recognition is best demonstrated by
    a. not recognizing any expense unless some revenue is realized.
    b. matching effort (expense) with accomplishment (revenue).
    c. recognizing prepaid rent received as revenue.
    d. establishing an Appropriation for Contingencies account.

Ans: b, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

94. Which of the following serves as the justification for the periodic recording of depreciation expense?
    a. Association of efforts (expense) with accomplishments (revenue)
    b. Systematic and rational allocation of cost over the periods benefited
    c. Immediate recognition of an expense
    d. Minimization of income tax liability

Ans: b, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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95. Application of the full disclosure principle
    a. is theoretically desirable but not practical because the costs of complete disclosure exceed the benefits.
    b. is violated when important financial information is buried in the notes to the financial statements.
    c. is demonstrated by the use of supplementary information explaining the effects of financing arrangements.
    d. requires that the financial statements be consistent and comparable.

Ans: c, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

96. Which of the following is an argument **against** using historical cost in accounting?
    a. Fair values are more relevant.
    b. Historical costs are based on an exchange transaction.
    c. Historical costs are reliable.
    d. Fair values are subjective.

Ans: a, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

97. When is revenue generally recognized?
    a. When cash is received
    b. When the warranty expires
    c. When production is completed
    d. When the company satisfies the performance obligation

Ans: d, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

98. Which of the following is a component of the revenue recognition principle?
    a. Cash is received and the amount is material.
    b. Recognition occurs when the performance obligation is satisfied.
    c. Production is complete and there is an active market for the product.
    d. Cash is realized or realizable and production is complete.

Ans: b, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

99. A company has a performance obligation when it agrees to
    a. perform a service for a customer and receives cash payment.
    b. sell a product to a customer after receiving payment.
    c. perform a service or sell a product to a customer.
    d. None of the answer choices are correct.

Ans: c, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

100. Which of the following is **not** a required component of financial statements prepared in accordance with generally accepted accounting principles?
    a. President's letter to shareholders.
    b. Balance sheet.
    c. Income statement.
    d. Notes to financial statements.

Ans: a, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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101. What is the general approach as to when product costs are recognized as expenses?
   a. In the period when the expenses are paid
   b. In the period when the expenses are incurred
   c. In the period when the vendor invoice is received
   d. In the period when the related revenue is recognized

Ans: d, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

102. **Not** adjusting the amounts reported in the financial statements for inflation is an example of which basic assumption or principle of accounting?
   a. Economic entity
   b. Going concern
   c. Monetary unit
   d. Full disclosure

Ans: c, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

103. Recognition of amortization of an intangible asset illustrates which principle of accounting?
   a. Expense recognition
   b. Full disclosure
   c. Revenue recognition
   d. Historical cost

Ans: a, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

104. When should an expenditure be recorded as an asset rather than an expense?
   a. Never
   b. Always
   c. If the amount is material
   d. When future benefit exists

Ans: d, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

105. Which accounting assumption or principle is being violated if a company reports its corporate headquarter building at its fair value on the balance sheet?
   a. Going concern
   b. Monetary unit
   c. Historical cost
   d. Full disclosure

Ans: c, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

106. Which accounting assumption or principle is being violated if a company is a party to major litigation that it may lose and decides not to include the information in the financial statements because it may have a negative impact on the company's stock price?
   a. Full disclosure.
   b. Going concern.
   c. Historical cost.
   d. Expense recognition.

Ans: a, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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107. Which assumption or principle requires that all information significant enough to affect decisions of reasonably informed users should be reported in the financial statements?
   a. Matching.
   b. Going concern.
   c. Historical cost.
   d. Full disclosure.

Ans: d, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

108. A company has a factory building that originally cost the company $250,000. The current fair value of the factory building is $3 million. The president would like to report the difference as a gain. The write-up would represent a violation of which accounting assumption or principle?
   a. Revenue recognition
   b. Going concern
   c. Historical cost
   d. Monetary unit

Ans: c, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

109. Which of the following is a constraint in presenting financial information?
   a. Cost
   b. Full disclosure
   c. Relevance
   d. Consistency

Ans: a, LO: 4, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

110. All of the following represent costs of providing financial information **except**
   a. processing/preparing.
   b. disseminating.
   c. accessing capital.
   d. auditing.

Ans: c, LO: 4, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

111. Which of the following is a benefit of providing financial information?
   a. Potential litigation
   b. Auditing
   c. Disclosure to competition
   d. Improved allocation of resources

Ans: d, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

112. Materiality is used in all of the following situations of providing financial information, **except**
   a. where an amount is of relative large size and importance.
   b. where it would impact the judgment of a reasonable person.
   c. where it would not make a difference in the actions of a decision maker.
   d. where omission of the information would result in bias.

Ans: c, LO: 2, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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113. What is prudence or conservatism?
   a. Understating assets and net income
   b. When in doubt, recognizing the option that is least likely to overstate assets and income
   c. Recognizing the option that is least likely to overstate assets and liabilities
   d. Recognizing revenue when earned and realized

Ans: b, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

114. Expensing the cost of copy paper when the paper is acquired is an example
   a. materiality.
   b. expense recognition.
   c. conservatism.
   d. industry practices.

Ans: a, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

115. Which of the following statements concerning the cost-benefit relationship is **not** true?
   a. Business reporting should exclude information outside of management's expertise.
   b. Management should not be required to report information that would significantly harm the company's competitive position.
   c. Management should not be required to provide forecasted financial information.
   d. If needed by financial statement users, management should gather information not included in the financial statements that would not otherwise be gathered for internal use.

Ans: d, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

116. Which of the following relates to both relevance and faithful representation?
   a. Cost constraint
   b. Predictive value
   c. Verifiability
   d. Neutrality

Ans: a, LO: 4, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

117. Expensing the cost of a wastebasket with an estimated useful life of 10 years when purchased is an example of the application of the
   a. consistency characteristic.
   b. expense recognition principle.
   c. materiality ingredient.
   d. historical cost principle.

Ans: c, LO: 2, Bloom: C, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

118. Which of the following statements about materiality is correct?
   a. An item must make a difference or it need not be disclosed.
   b. Materiality is a matter of relative size or importance.
   c. An item is material if its inclusion or omission would influence or change the judgment of a reasonable person.
   d. All of these answers are correct.

Ans: d, LO: 2, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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119. Which of the following is considered a pervasive constraint by *Statement of Financial Accounting Concepts No. 8*?
   a. Comparability
   b. Timeliness
   c. Verifiability
   d. Cost constraint

Ans: d, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

120. The cost constraint is also referred to as the
   a. cost-benefit relationship.
   b. materiality quality.
   c. monetary unit assumption.
   d. measurement principle.

Ans: a, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

121. The second level of the conceptual framework includes each of the following **except**
   a. elements.
   b. principles.
   c. enhancing qualities.
   d. fundamental qualities.

Ans: b, LO: 4, Bloom: C, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

122. Trade-offs between the characteristics that make information useful may be necessary or beneficial. Issuance of interim financial statements is an example of a trade-off between
   a. relevance and faithful representation.
   b. faithful representation and periodicity.
   c. timeliness and materiality.
   d. understandability and timeliness.

Ans: a, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

123. Allowing firms to estimate rather than physically count inventory at interim (quarterly) periods is an example of a trade-off between
   a. verifiability and faithful representation.
   b. faithful representation and comparability.
   c. timeliness and verifiability.
   d. neutrality and consistency.

Ans: c, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

[P]124. The third level of the conceptual framework does **not** include
   a. assumptions.
   b. constraint.
   c. elements.
   d. principles.

Ans: c, LO: 4, Bloom: C, Difficulty: Difficult, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	c	37.	c	53.	a	69.	d	85.	d	101.	d	117.	c
22.	d	38.	a	54.	c	70.	c	86.	c	102.	c	118.	d
23.	c	39.	b	55.	d	71.	d	87.	d	103.	a	119.	d
24.	d	40.	d	56.	b	72.	c	88.	d	104.	d	120.	a
25.	d	41.	a	57.	b	73.	b	89.	d	105.	c	121.	b
26.	d	42.	d	58.	d	74.	b	90.	c	106.	a	122.	a
27.	a	43.	a	59.	d	75.	a	91.	b	107.	d	123.	c
28.	d	44.	c	60.	c	76.	c	92.	b	108.	c	124.	c
29.	a	45.	b	61.	c	77.	c	93.	b	109.	a		
30.	a	46.	b	62.	d	78.	d	94.	b	110.	c		
31.	a	47.	d	63.	b	79.	a	95.	c	111.	d		
32.	b	48.	c	64.	d	80.	b	96.	a	112.	c		
33.	c	49.	d	65.	b	81.	a	97.	d	113.	b		
34.	c	50.	b	66.	a	82.	d	98.	b	114.	a		
35.	a	51.	d	67.	b	83.	d	99.	c	115.	d		
36.	d	52.	c	68.	a	84.	a	100.	a	116.	a		

Solutions to those Multiple Choice questions for which the answer is “none of these answer choices are correct.”

55. A company changes its inventory method every few years in order to maximize reported income (other answers are possible).
58. Comparability.
62. Change in equity of an entity during a period from transactions and other events and circumstances from nonowner sources.
82. Going concern assumption.
87. The performance obligation is satisfied.

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MULTIPLE CHOICE—CPA Adapted

125. According to the FASB's conceptual framework, predictive value is an ingredient of

	Relevance	Faithful Representation
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

Ans: a, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

126. According to the FASB's conceptual framework, which of the following relates to both relevance and faithful representation?

	Comparability	Neutrality
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

Ans: b, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

127. The FASB's conceptual framework classifies gains and losses based on whether they are related to an entity's major ongoing or central operations. These gains or losses may be classified as

	Nonoperating	Operating
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

Ans: b, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

128. According to the FASB's conceptual framework, which of the following enhances information that is relevant and faithfully represented?
a. Neutrality.
b. Comparability.
c. Confirmatory value.
d. Materiality.

Ans: b, LO: 2, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

129. Under SFAC No.6, interrelated elements of financial statements that are directly related to measuring the performance and status of an enterprise include

	Owners Distributions to	Notes to Financial Statements
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

Ans: a, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

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130. According to the FASB's conceptual framework, the calculation of comprehensive income includes which of the following?

	Income from Continuing Operations	Distributions to Owners
a.	No	No
b.	Yes	No
c.	Yes	Yes
d.	No	Yes

Ans: b, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: reporting, AICPA PC: Communication, IMA: FSA, IFRS: None

131. According to the FASB's conceptual framework, what does the concept of faithful representation include?
a. Verifiability
b. Predictive value
c. Materiality
d. Neutrality

Ans: d, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: reporting, AICPA PC: Communication, IMA: Reporting, IFRS: None

132. According to the FASB's conceptual framework, which of the following is an essential characteristic of an asset?
a. The claims to an asset's benefits are legally enforceable.
b. An asset is tangible.
c. An asset is obtained at a cost.
d. An asset provides future benefits.

Ans: d, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: Reporting, IFRS: None

133. Which of the following is an application of rational and systematic allocation?
a. Amortization of intangible assets.
b. Sales commissions.
c. Research and development costs.
d. Officers' salaries.

Ans: a, LO: 2, Bloom: K, Difficulty: Easy, Min: 2, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
125.	a	127.	b	129.	a	131.	d	133.	a
126.	b	128.	b	130.	b	132.	d		

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BRIEF EXERCISES

BE. 2-134—Qualitative Characteristics.

Accounting information provides useful information about business transactions and events. Those who provide and use financial reports must often select and evaluate accounting alternatives. The FASB statement on qualitative characteristics of accounting information examines the characteristics of accounting information that make it useful for decision-making. It also points out that various limitations inherent in the measurement and reporting process may necessitate trade-offs or sacrifices among the characteristics of useful information.

Instructions.

(a) Describe briefly the following characteristics of useful accounting information.

(1) Relevance
(2) Faithful representation
(3) Understandability
(4) Comparability
(5) Consistency

(b) For each of the following pairs of information characteristics, give an example of a situation in which one of the characteristics may be sacrificed in return for a gain in the other.

(1) Relevance and faithful representation.
(2) Relevance and consistency.
(3) Comparability and consistency.
(4) Relevance and understandability.

(c) What criterion should be used to evaluate trade-offs between information characteristics?

Ans: NA, LO: 2, 4, Bloom: C, Difficulty: Difficult, Min: 15-20, AACSB: None, AICPA BB: None, AICPA FN: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS: None

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Solution 2-134.

(a) (1) Relevance is one of the two fundamental qualities of useful accounting information. Relevant information is capable of making a difference in a decision. Relevant information helps users to make predictions about the outcomes of past, present, and future events, or to confirm or correct prior expectations. Materiality is a company-specific aspect of relevance.

(2) Faithful representation is one of the two fundamental qualities of useful accounting information. Reliable information can be depended upon to represent the conditions and events that it is intended to represent. Representational faithfulness is correspondence or agreement between accounting information and the economic phenomena it is intended to represent stemming from completeness, neutrality, and free from error.

(3) Understandability is an enhancing quality of information. Information is understandable when it permits reasonably informed users to perceive its significance. Understandability is a link between users, who vary widely in their capacity to comprehend or utilize the information, and the fundamental qualities of information.

(4) Comparability means that information about companies has been prepared and presented in a similar manner. Comparability enhances comparisons between information about two different companies at a particular point in time.

(5) Consistency means that unchanging policies and procedures have been used by a company from one period to another. Consistency enhances comparisons between information about the same company at two different points in time.

(b) (**Note to instructor**: There are a multitude of answers possible here. The suggestions below are intended to serve as examples).

(1) Forecasts of future operating results and projections of future cash flows may be highly relevant to some decision makers. However, they would not be as free from error as historical cost information about past transactions.

(2) Proposed new accounting methods may be more relevant to many decision makers than existing methods. However, if adopted, they would impair consistency and make trend comparisons of an enterprise's results over time difficult or impossible.

(3) There presently exists much diversity among acceptable accounting methods and procedures. In order to facilitate comparability between enterprises, the use of only one accepted accounting method for a particular type of transaction could be required. However, consistency would be impaired for those firms changing to the new required methods.

(4) Occasionally, relevant information is exceedingly complex. Judgment is required in determining the optimum trade-off between relevance and understandability. Information about the impact of general and specific price changes may be highly relevant but not understandable by all users.

(c) Although trade-offs result in the sacrifice of some desirable quality of information, the overall result should be information that is more useful for decision making.

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BE. 2-135—Accounting concepts—identification.

State the accounting assumption, principle, or constraint that is most applicable in the following cases.

1. All payments less than $25 are expensed as incurred.
2. The company employs the same inventory valuation method from period to period.
3. A patent is capitalized and amortized over the periods benefited.
4. Assuming that dollars today will buy as much as ten years ago.
5. Rent paid in advance is recorded as prepaid rent.
6. Financial statements are prepared each year.
7. All significant post-balance sheet events are reported.
8. Personal transactions of the proprietor are distinguished from business transactions.

Ans: NA, LO: 2, 3, 4, Bloom: C, Difficulty: Moderate, Min: 8-10, AACSB: None, AICPA BB: None., AICPA FC: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS: None

Solution 2-135

1. Materiality quality
2. Consistency quality
3. Expense recognition principle or going concern assumption
4. Monetary unit assumption
5. Expense recognition principle or going concern assumption
6. Periodicity assumption
7. Full disclosure principle
8. Economic entity assumption

BE. 2-136—Accounting concepts—identification.

Presented below are a number of accounting procedures and practices at Ramirez Corp. For each of these items, list the assumption, principle, quality, or modifying convention that is violated.

1. Because the company's income is low this year, a switch from accelerated depreciation to straight-line depreciation is made this year.
2. The president of Ramirez Corp. believes it is foolish to report financial information on a yearly basis. Instead, the president believes that financial information should be disclosed only when significant new information is available related to the company's operations.
3. Ramirez Corp. decides to establish a large loss and related liability this year because of the possibility that it may lose a pending patent infringement lawsuit. The possibility of loss is considered remote by its attorneys.
4. An officer of Ramirez Corp. purchased a new home computer for personal use with company money, charging miscellaneous expense.
5. A machine, that cost $40,000, is reported at its current market value of $45,000.

Ans: NA, LO: 2, 3, 4, Bloom: C, Difficulty: Difficult, Min: 10, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS: None

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Solution 2-136

1. Consistency.
2. Periodicity.
3. Expense recognition (also, conservatism).
4. Economic entity.
5. Historical cost (also, revenue recognition)*.

*Reporting the asset at FV of $45,000 implies the following entry:

Equipment	5,000	
Gain		5,000

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EXERCISES

Ex. 2-137—Accounting concepts—matching.

Listed below are several information characteristics and accounting principles and assumptions. Match the letter of each with the appropriate phrase that states its application. (Items *a* through *k* may be used more than once or not at all.)

a. Economic entity assumption
b. Going concern assumption
c. Monetary unit assumption
d. Periodicity assumption
e. Historical cost principle
f. Revenue recognition principle
g. Expense recognition principle
h. Full disclosure principle
i. Relevance characteristic
j. Faithful representation characteristic
k. Consistency characteristic

____ 1. Stable-dollar assumption (do not use historical cost principle).

____ 2. The performance obligation is satisfied.

____ 3. Numbers and descriptions match what really existed or happened.

____ 4. Yearly financial reports.

____ 5. Accruals and deferrals in adjusting and closing process. (Do not use going concern.)

____ 6. Useful standard measuring unit for business transactions.

____ 7. Notes as part of necessary information to a fair presentation.

____ 8. Affairs of the business distinguished from those of its owners.

____ 9. Company assumed to have a long life.

____ 10. Valuing assets at amounts originally paid for them.

____ 11. Application of the same accounting principles as in the preceding year.

____ 12. Summarizing significant accounting policies.

____ 13. Presentation of timely information with predictive and confirmatory value.

Ans: NA, LO: 2, 3, 4, Bloom: K, Difficulty: Easy, Min: 13, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS: None

Solution 2-137

1. c	4. d	7. h	10. e	13. i
2. f	5. g	8. a	11. k	
3. j	6. c	9. b	12. h	

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Ex. 2-138—Accounting concepts—fill in the blanks.

Fill in the blanks below with the accounting principle, assumption, or related item that *best* completes the sentence.

1. _____ and _____ are the two fundamental qualities that make accounting information useful for decision making.

2. Information that helps users confirm or correct prior expectations has _____ _____.

3. _____ enables users to identify the real similarities and differences in economic events between companies.

4. _____ is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

5. Information is _____ if omitting it or misstating it could influence decisions that users make on the basis of the reported financial information.

6. The _____ characteristic requires that the same accounting method be used from one accounting period to the next, unless it becomes evident that an alternative method will bring about a better description of a firm's financial situation.

7. _____ means that a company cannot select information to favor one set of interested parties over another.

8. Providing information that is of sufficient importance to influence the judgement and decisions of an informed user is referred to as _____.

9. Corporations must prepare accounting reports at least yearly due to the _____ assumption.

10. _____ occurs when the performance obligation is satisfied.

Ans: NA, LO: 2, 3, 4, Bloom: K, Difficulty: Easy, Min: 10, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

Solution 2-138

1. Relevance; faithful representation
2. confirmatory value
3. Comparability
4. Fair value
5. material
6. consistency
7. Neutrality
8. full disclosure
9. periodicity
10. Revenue recognition

Ex. 2-139—Basic assumptions.

Briefly explain the four basic assumptions that underlie financial accounting.

Ans: NA, LO: 3, Bloom: K, Difficulty: Easy, Min: 8, AACSB: None, AICPA BB: None, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

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Solution 2-139

1. The economic entity assumption states that economic activity can be identified with a particular unit of accountability.
2. The going concern assumption assumes that a company will have a long life.
3. The monetary unit assumption means that money is the common denominator of economic activity and provides an appropriate basis for accounting measurement and analysis. In addition, the monetary unit remains reasonably stable.
4. The periodicity assumption implies that a company can divide its economic activities into artificial time periods.

Ex. 2-140—Historical cost principle.

Cost as a basis of accounting for assets has been severely criticized. What defense can you build for cost as the basis for financial accounting?

Ans: NA, LO: 4, Bloom: E, Difficulty: Moderate, Min: 5-10, AACSB: Reflective Thinking, AICPA BB: Crit. Think., AICPA FN: Measurement, AICPA PC: Problem Solving and Decision Making, IMA: Reporting, IFRS: None

Solution 2-140

Cost is definite and verifiable and not a matter for conjecture or opinion. Once established, cost is fixed as long as the asset remains the property of the party that incurred the cost. Cost is based on fact; that is, it is the result of an arm's length transaction. Cost is also measurable or determinable. Over the years, accountants have found cost to be the most practical basis for record keeping. Financial statements prepared on a cost basis provide business enterprise information having a common, accepted basis from which each reader can make inferences, comparisons, and analyses.

Ex. 2-141—Expense recognition concept.

A concept is a group of related ideas. Matching could be considered a concept because it includes ideas related to expense recognition. Briefly explain the ideas in expense recognition.

Ans: NA, LO: 4, Bloom: C, Difficulty: Moderate, Min: 10, AACSB: None, AICPA BB: None, AICPA FN: Measurement, AICPA PC: Communication, IMA: FSA, IFRS: None

Solution 2-141

The ideas in expense recognition include "expense" and "matching":

1. Expenses are outflows of net assets during a period from delivering or producing goods or services or other activities that are the major operations of the entity.
2. Expenses are recognized when the goods or services (efforts) make their contribution to revenue.

The expense recognition principle is that expenses are matched with revenues. Expenses are matched three ways:

1. When there is an association with revenue, expenses are matched with revenues in the period the revenues are recognized.
2. When no association with revenue is evident, expenses are allocated on some systematic and rational basis.
3. When no association with revenue is evident and no future benefits are expected, expenses are recognized immediately.

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IFRS QUESTIONS

True / False

1. The IASB and the FASB are working on a joint project to develop a common conceptual framework.

Ans: T, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

2. Under IFRS, expenses include losses that are not the result of ordinary activities.

Ans: T, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS

3. Under IFRS, it is mandatory to report property, plant, and equipment at historical cost.

Ans: F, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Measurement, AICPA PC: Communication, IMA: Reporting, IFRS

4. The number of financial statement elements in the IFRS conceptual framework is equal to those in GAAP.

Ans: F, LO: 5, Bloom: K, Difficulty: Moderate, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS

5. The existing conceptual frameworks underlying GAAP and IFRS are very similar.

Ans: T, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

6. It is unlikely that the basic concepts related to the existing conceptual framework will change.

Ans: T, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

7. The IASB is considering a proposal to provide expanded guidance on estimating fair values.

Ans: T, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

8. GAAP has a concept statement to guide estimation of fair values when market-related data is **not** available.

Ans: T, LO: 5, Bloom: C, Difficulty: Moderate, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

9. The monetary unit assumption is a part of GAAP, but **not** IFRS.

Ans: F, LO: 5, Bloom: K, Difficulty: Easy, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

10. A company incorporated in Japan uses the dollar as its unit of measurement.

Ans: F, LO: 5, Bloom: K, Difficulty: Moderate, Min: 1, AACSB: Diversity, AICPA BB: International, AICPA FC: Measurement, AICPA PC: Communication, IMA: Reporting, IFRS

Answers to True / False questions:

1. True
2. True
3. False
4. False
5. True
6. True
7. True
8. True
9. False
10. False

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Multiple Choice:

11. The IASB and the FASB are working on a joint project that has an objective of developing a conceptual framework that leads to standards that are:
    a. rule-based and internally consistent.
    b. principle-based and internally consistent.
    c. rule-based and flexible in nature.
    d. principle-based and rigid in nature.

Ans: b, LO: 5, Bloom: K, Difficulty: Easy, Min: 2, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: FSA, IFRS

12. Which of the following is an element of financial statements identified under IFRS?
    a. Investment by owners
    b. Losses
    c. Comprehensive income
    d. Equity

Ans: d, LO: 5, Bloom: K, Difficulty: Easy, Min: 2, AACSB: Diversity, AICPA BB: International, AICPA FC: Reporting, AICPA PC: Communication, IMA: Reporting, IFRS

13. Under IFRS, a decrease in economic benefit that results in a decrease in equity is termed as a(an):
    a. Loss of economic benefit
    b. Comprehensive loss
    c. Expense
    d. Distributions to owners

Ans: c, LO: 5, Bloom: K, Difficulty: Moderate, Min: 2, AACSB: Diversity, AICPA BB: International, AICPA FC: Measurement, AICPA PC: Communication, IMA: FSA, IFRS

Answers to Multiple Choice:

11. b
12. d
13. c

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