Chapter 2
Accounting Standards and Ethics

True/False Questions

1. Accounting standards were previously set at the national level but now are all established at the international level.
   False
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2. International accounting standards use a principle-based approach.
   True
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3. Principles-based standards are criticized because management has an incentive to apply them by the 'letter of the law' rather than the 'spirit of the law' as a means of circumventing certain requirements.
   False
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4. A major advantage of principles-based standards is that they are flexible enough to be applied in different jurisdictions, each of which can have its own implementation of the standard in a way that satisfied local laws and culture.
   True
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5. A major criticism of rules-based standards is that management has too much latitude in their application and therefore uncertainty is created about whether a company is in compliance or not.
   False
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6. The IASC Foundation creates international accounting standards.
   False
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7. International Financial Reporting Standards (IFRS) include International Financial Reporting Standards provided by the International Accounting Standards Board (IASB) as well as International Accounting Standards (IAS), interpretations by the International Financial Reporting Interpretations Committee (IFRIC) and the former Standing Interpretations Committee.
   True
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8. International Financial Reporting Standards (IFRS) interpretations by the International Financial Reporting Interpretations Committee (IFRIC).
   True
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9. International Financial Reporting Standards (IFRS) include International Financial Reporting Standards provided by the International Accounting Standards Board (IASB) but not International Accounting Standards (IAS) that were established by the International Accounting Standards Committee (IASC) that preceded the IASB.
   False
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10. International Financial Reporting Standards (IFRS) are set by the International Accounting Standards Board (IASB).
    True
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11. Advice provided by the Standards Advisory Council is considered to be part of International Financial Reporting Standards (IFRS).
    False
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12. Holding public hearings is a mandatory step in the IASB standard-setting process.
    False
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13. Consulting the Standards Advisory Committee on major projects, agenda decisions and work priorities is a mandatory step in the IASB standard-setting process.
    True
    Page: p72

14. Publishing a discussion document is a non-mandatory step in the IASB standard-setting process.
    True
    Page: p72

15. Publishing bases for conclusions with standards and exposure drafts is a non-mandatory step in the IASB standard-setting process.
    False
    Page: p72

16. Undertaking field tests both in developed countries and emerging markets is a mandatory step in the IASB standard-setting process.
    False
    Page: p72

17. The Framework for the Preparation and Presentation of Financial Statements is an example of one accounting standard established by the International Accounting Standards Board (IASB).
False
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18. The three levels of authoritative guidance listed in order are IFRS, the Framework for the Preparation and Presentation of Financial Statements and management judgment.
True
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19. The two underlying assumptions in the Framework for the Preparation and Presentation of Financial Statements are going concern and accrual basis.
True
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20. On 25 April 2010, employees provide services to a company for €15,000. The company pays for these services on 4 May 2010. Under accrual basis accounting, the effect of these services will be reported in May 2010.
False
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21. The accrual basis of accounting requires that transactions be recorded in the period when payment is received or made by the company.
False
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22. Going concern refers to the assumption that a business entity will continue operating without threat of liquidation in the foreseeable future.
True
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23. The four qualitative characteristics of financial statements defined by the Framework for the Preparation and Presentation of Financial Statements are 1) comparability, 2) relevance, 3) reliability and 4) understandability.
True
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24. One constraint on relevant and reliable information as defined by the Framework for the Preparation and Presentation of Financial Statements is prudence.
False
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25. One constraint on relevant and reliable information as defined by the Framework for the Preparation and Presentation of Financial Statements is that financial statements should present a true and fair view.
True
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26. One constraint on relevant and reliable information as defined by the Framework for the Preparation and Presentation of Financial Statements is timeliness.
    True
    Page: p76

27. An external user assumes that IFRS have been used to prepare financial statement unless there is an explicit and unreserved statement in the notes to the financial statements than another accounting standard was used.
    False
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28. In accounting, information is material if omission or misstatement of that information could influence the economic decisions of users.
    True
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29. A reporting entity is normally not allowed to offset assets and liabilities.
    True
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30. International Financial Reporting Standards (IFRS) require that a business present a complete set of financial statement at least once annually even though the business may elect to present financial statement more frequently.
    True
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31. International Financial Reporting Standards (IFRS) require that a business present at least three years' comparable information when the business presents its annual financial statements.
    False
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32. Realizable value means that assets are recorded for an amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them.
    False
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33. Present value means that assets are carried at the discounted value of future net cash inflows that the asset is expected to generate, while liabilities are carried at the discounted value of the net cash outflows expected to settle the obligation in the normal course of business.
    True
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34. Under historical cost, liabilities are measured by the amount of proceeds exchanged for the obligation.
    True
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35. One issue within professional ethics is whether professionals including accountants are able to make independent judgments about their work.
True
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Multiple Choice Questions

1. Which of the following statements is not correct?
    a. Some nations have converged their national standards with International Financial Reporting Standards
    b. Some nations have not converged their national standards with International Financial Reporting Standards
    c. By the year 2012, all nations will be required to use International Financial Reporting Standards
    d. Accounting standards are still established at the national level

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2. Which of the following is not a characteristic of rules-based standards?
    a. Rules-based standards must be clear and understandable in their application and enforcement
    b. Rules-based standards can be more flexibly applied in different jurisdictions
    c. Rules-based standards must be comprehensive to avoid gaps that fail to provide guidance in all circumstances
    d. Critics believe that rules-based standards give management an incentive to apply standards by the 'letter of the law' rather than in the 'spirit of the law'

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3. Which of the following is not a characteristic of principles-based standards?
    a. Principles-based standards provide specific guidelines for those who prepare financial statements
    b. Critics believe that principles-based standards create some uncertainty about whether a company is in compliance or not
    c. Critics believe that management has too much latitude in the application of principles-based standards
    d. With principles-based standards, it is easier to have implementations that satisfy local laws and culture

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4. International Financial Reporting Standards (IFRS) are now established by:
    a. the International Monetary Fund
    b. the International Accounting Standards Committee
    c. the IASC Foundation
    d. the International Accounting Standards Board

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5. International Financial Reporting Standards (IFRS) include all except which of the following:
    a. interpretations by the International Financial Reporting Interpretations Committee
    b. Pronouncements by the Standards Advisory Council
    c. International Financial Reporting Standards (IFRS) as currently established by the IASB
    d. International Accounting Standards

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6. Which of the following is not an objective of the International Accounting Standards Board?
    a. Promote the use and rigorous application of IFRS
    b. Follow directives issued by national accounting standards organizations
    c. Develop a single set of high quality, understandable and enforceable global standards
    d. Work actively with national standard-setters to bring about convergence of national accounting standards with IFRS

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7. The organization that is responsible for ensuring that IASB board members are selected for the best combination of technical skills and background experience on relevant international business and market conditions is the:
    a. IASC Foundation
    b. International Accounting Standards Board
    c. Standards Advisory Council
    d. International Financial Reporting Interpretations Committee

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8. Which of the following are requirements for developing international accounting standards?
   1- Extensive consultation and responsiveness
   2- Transparency and accessibility
   3- Accountability
   4- Collating responses to discussion papers and exposure drafts

    a. 1, 2 and 3 only
    b. 2, 3 and 4 only
    c. 1, 2 and 4 only
    d. All four are requirements

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9. Which of the following is not a mandatory step in the IASB standard-setting process?
    a. Establishing procedures for reviewing comments made within a reasonable period on documents published for comment.
    b. Publishing bases for conclusions with standards and exposure drafts.
    c. Preparing and issuing standards and exposure drafts, each of which is to include any dissenting opinions.
    d. Publishing a discussion document

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10. Which of the following is the correct sequence for obtaining authoritative guidance when preparing financial statements according to the IASB Framework for the Preparation and Presentation of Financial Statements?
    1- National standards other than IFRS
    2- The Framework for the Preparation and Presentation of Financial Statements
    3- Public accountants
    4- IFRS
    5- Management judgment
    a. 1, 2, 4 and then 3
    b. 1, 2, 4 and then 5
    c. 4, 2 and then 5
    d. 4, 1 and then 3
    Page: p74

11. Which concept relates to the reporting of the effects of transactions when they occur and not necessarily when cash is received or paid?
    a. Time period assumption
    b. Accrual basis
    c. Going concern
    d. Double-entry assumption
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12. Which concept relates to the assumption that a business entity will continue to operate without threat of liquidation in the foreseeable future?
    a. Accrual basis
    b. Going concern
    c. Entity assumption
    d. Reporting assumption
    Page: p75

13. Qualitative characteristics that make information provided in financial statements useful to users include which of the following:
    1- relevance
    2- integrity
    3- understandability
    4- cost effectiveness
    5- comparability
    6- timeliness
    7- reliability
    a. 2, 4, 6 and 7
    b. 1, 2, 5 and 6
    c. 2, 3, 4 and 7
    d. 1, 3, 5 and 7
    Page: p75

14. The qualitative characteristic of financial statements that assumes that users have a reasonable knowledge of business, economic activities and financial accounting, and will study the information with reasonable diligence to comprehend its meaning is which of the following?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability

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15. The qualitative characteristic of financial statements that describes information that is free from material error and faithfully represents what it purports to represent is which of the following?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability

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16. Consistency relates to which of the following qualitative characteristic of financial statements?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability

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17. Prudence relates to which of the following qualitative characteristic of financial statements?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability

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18. Completeness relates to which of the following qualitative characteristic of financial statements?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability

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19. Substance over form relates to which of the following qualitative characteristic of financial statements?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability

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20. Neutrality relates to which of the following qualitative characteristic of financial statements?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability
    Page: p76

21. Faithful reprentations relates to which of the following qualitative characteristic of financial statements?
    a. Reliability
    b. Relevance
    c. Understandability
    d. Comparability
    Page: p76

22. Which of the following is not a constraint on relevant and reliable information as identified in the IASB Framework for the Preparation and Presentation of Financial Statements?
    a. Fair presentation
    b. Balance between qualitative characteristics
    c. Prudence
    d. Timeliness
    Page: p76

23. If the omission or misstatement could influence the economic decisions of users on the basis of financial statements, then information is which of the following?
    a. Timely
    b. Material
    c. Relevant
    d. Reliable
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24. Lam Corporation owes Ling Ltd. ¥50,000. Ling owes Lam ¥45,000. Which of the following is correct about reporting this information according to the IASB Framework for the Preparation and Presentation of Financial Statements?
    a. Lam should report a negative trade accounts payable amount of ¥5,000
    b. Lam should report assets of ¥50,000
    c. Ling should report assets of ¥5,000
    d. Ling should report assets of ¥45,000
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25. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures liabilities at the amount of cash or cash equivalents that would currently be required to settle the obligation?
    a. **Current cost**
    b. Present value
    c. Historical cost
    d. Realizable value

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26. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures liabilities by the amount of proceeds exchanged for the obligation?
    a. Current cost
    b. Present value
    c. **Historical cost**
    d. Realizable value

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27. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures liabilities at the discounted value of the net cash outflows expected to settle the obligation in the normal course of business?
    a. Current cost
    b. **Present value**
    c. Historical cost
    d. Realizable value

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28. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures liabilities at the amount of cash or cash equivalents that would be needed to settle the obligation in the normal course of business?
    a. Current cost
    b. Present value
    c. Historical cost
    d. **Realizable value**

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29. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures assets based on the amount of cash or cash equivalents that would be paid if they were acquired currently?
    a. **Current cost**
    b. Present value
    c. Historical cost
    d. Realizable value

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30. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures assets based on an amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them?
    a. Current cost
    b. Present value
    c. Historical cost
    d. Realizable value

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31. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures assets at the discounted value of future net cash inflows that the asset is expected to generate?
    a. Current cost
    b. Present value
    c. Historical cost
    d. Realizable value

    Page: p82

32. Which of the following measurement concepts described in the IASB Framework for the Preparation and Presentation of Financial Statements measures assets at an amount of cash or cash equivalents that would be paid if they were acquired currently?
    a. Current cost
    b. Present value
    c. Historical cost
    d. Realizable value

Essay Questions

1. Explain the difference between rules-based and principles-based standards? What are the criticisms of each approach? Which approach does the International Financial Reporting Standards use?

   Answer
   Rules-based standards provide specific guidelines but these guidelines must be clear and understandable in their application and enforcement. They must also be comprehensive so as to not leave gaps in the guidance provided. Principles-based standards focus on broad objectives and are therefore can be flexibly applied to different jurisdictions. Thus, implementation is easier across different cultures.

   Critics believe that rules-based standards cause management to apply rules by the 'letter of the law' rather than focusing on a true and fair view of the reporting entity's financial condition. Critics of principles-based standards believe that it is difficult to determine whether a reporting entity has complied with the standards or not.

   IFRS use a principle-based approach to standards.

2. What are the objectives of the International Accounting Standards Board?

   Answer
   - To develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions;
   - To promote the use and rigorous application of those standards; and
   - To work actively with national standard-setters to bring about convergence of national accounting standards and IFRSs to high quality solutions."

3. Describe the six stages in the proper sequence that the International Accounting Standards Board uses to set standards.
   Answer
   1. <u>Setting the agenda</u> – The IASB considers the following criteria when setting its agenda:
      a. The relevance to users of the information and the reliability of information that could be provided
      b. Existing guidance available
      c. The possibility of increasing convergence
      d. The quality of the standard to be developed
      e. Resource constraints.

   2. <u>Project planning</u> – The IASB can decide whether it wishes to work alone on a specific project or jointly with another standard-setter. In some cases, the IASB may establish a working

group. The Director of Technical Activities and the Director of Research select a project team and appoint a project manager who draws up a project plan.

3. Development and publication of a discussion paper. A discussion paper typically includes a comprehensive overview of the issue, possible approaches to addressing the issue, preliminary of views of the authors or the IASB, and an invitation to comment. Normally 120 days is allowed for comment.

4. Development and publication of exposure draft. A mandatory exposure draft of the published setting out the proposed standard, or amendment to an existing standard. The IASB invites comments typically for a period of 120 days, though for shorter periods in some cases.

5. Development and publication of a standard. After resolving issues that arise in the exposure draft, the IASB has the option of publishing a second exposure draft or issuing the actual standard.

6. Procedures after a standard is issued. The IASB members and staff hold regular meetings with interested parties after the issuance of a standard to understand any unanticipated issues that may arise related to practical implementation or the standards potential impact.

4. What are the four measurement methods identified in the IASB Framework for the Preparation and Presentation of Financial Statements? Describe how each measures assets and liabilities?

Answer

1. Historical cost – Assets are recorded for an amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them. Liabilities are measured by the amount of proceeds exchanged for the obligation.

2. Current cost – Assets are valued based on the amount of cash or cash equivalents that would be paid if they were acquired currently. Liabilities are measured at the amount of cash or cash equivalents that would currently be required to settle the obligation.

3. Realizable value – Assets are carried at an amount of cash or cash equivalents that would be obtained by selling the asset in an orderly (not liquidation) disposal. Liabilities are carried at the amount of cash or cash equivalents that would be needed to settle the obligation in the normal course of business.

4. Present value – Assets are carried at the discounted value of future net cash inflows that the asset is expected to generate, while liabilities are carried at the discounted value of the net cash outflows expected to settle the obligation in the normal course of business.