

Student name: _____

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

The Conceptual Framework overrides IFRS Standards to ensure consistency with existing accounting policies.

true

false

ASPE is often different than IFRS due to the cost of preparing financial statements to comply with complex standards being greater than the benefit received by users of those statements.

true

false

The primary emphasis of the Conceptual Framework is the proper recognition of income and expenses.

true

false

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

In which of the following situations would professional judgment NOT be required in decision making?

Recognition of revenue.

The making of accounting estimates.

Disclosure of information in the notes to the financial statements.

Use of IFRS or ASPE for publicly traded companies in Canada.

Which of the following statements pertaining to generally accepted accounting principles (GAAP) in Canada is CORRECT?

CPA Canada harmonized its accounting standards with those of the United States.

A Canadian company listed on a stock exchange in the United States (U.S.) is permitted to use U.S. GAAP instead of IFRS.

Rate-regulated public companies (e.g., pipelines) not registered with the U.S. Securities and Exchange Commission are required to use IFRS.

Part I (i.e., IFRS) of the *CPA Canada Handbook* is only to be used by publicly accountable enterprises.

Which of the following examples does NOT demonstrate the interrelationships of financial statement elements?

A sale on account will increase assets and equity.

Depreciation of equipment will decrease assets and decrease equity.

The payment of a payable will decrease liabilities and increase assets.

The contribution of capital will increase an asset and increase equity.

Which of the following statements pertaining to GAAP for publicly accountable enterprises (PAEs) is correct?

PAEs include not-for-profit organizations.

Commencing in 2011, most Canadian PAEs are required to elect to report under either IFRS or ASPE on a prospective basis.

PAEs include an entity, that as one of its primary businesses, holds assets in a fiduciary capacity for a broad group of outsiders.

CPA Canada and the Financial Accounting Standards Board (FASB) harmonized the accounting standards of the United States and Canada for PAEs beginning in 1998.

Which of the following statements pertaining to private enterprises (PEs) is INCORRECT?

PEs may adopt either ASPE or IFRS but once a set of standards is adopted, the PEs are not permitted to apply some standards from ASPE and others from IFRS.

The accounting standards for a PE are included in a separate part of the CPA Canada Handbook.

PEs with annual revenues over \$10,000,000, are required to report under IFRS.

A PE is a profit-oriented enterprise that has none of its issued and outstanding financial instruments traded in a public market and does not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

Which of the following organizations are required to use only the IFRS (Part I) in Canada?

All corporations, government agencies and private companies.

Public companies and private companies whose shareholders' equity is in excess of \$500,000,000 at any particular year-end.

Public companies, private companies and not-for-profit organizations.

Government business enterprises.

Which of the following statements pertaining to Not-for-Profit-Organizations (NFPO) is INCORRECT?

A government NFPO has the choice to follow either the 4200 series of the CPA Canada *Public Sector Accounting (PSA) Handbook* or the *PSA Handbook* without the 4200 series.

A non-government NFPO has a choice to follow Part I (IFRS) or Part III of the *CPA Canada Handbook*.

A government NFPO has a choice to follow Part I (IFRS) of the *CPA Canada Handbook* or the *CPA Canada Public Sector Accounting Handbook*.

A non-government NFPO that applies Part III of the *CPA Canada Handbook* will also apply relevant sections from Part II (ASPE) of the *CPA Canada Handbook*.

For which of the following types of organizations does the *CPA Canada Handbook* NOT provide specific accounting standards?

Publicly accountable enterprises.

Private enterprises.

Not-for-profit organizations.

Proprietorships.

Which of the following is NOT a reason why a Canadian private company would elect to report under IFRS?

The company is planning to go public in the near future.

The company seeks comparability with public companies of a similar size.

It is likely to be less expensive than reporting under ASPE.

The company is a subsidiary of a Canadian public company.

The current ratio measures:

liquidity.

solvency.

profitability of assets.

profitability of owners' investment.

The formula for the return on equity ratio is:

current assets - current liabilities

current assets/current liabilities

total debt/shareholders' equity

net income/shareholders' equity

The debt-to-equity ratio measures:

liquidity.

solvency.

profitability of assets.

profitability of owners' investment.

Which of the following statements pertaining to the quality of financial statements or financial reporting is FALSE?

The quality of financial statements is low if the financial statements faithfully represent what happened during the past period.

The quality of financial reporting is based on how accurately the financial statements present the actual situation of the reporting entity.

The quality of the financial statements is low if they provide useless and unreliable information to assess the prospects of future earnings.

The quality of financial reporting is high if the investor is able to assess the likelihood of making a reasonable return with an acceptable level of risk.

Sonic Ltd. acquired equipment on January 1, 2026 at a cost of \$500,000. The equipment has an estimated useful life of 10 years and a residual value of \$25,000. It is depreciated on a straight-line basis and Sonic has a December 31 year-end.

On December 31, 2026 and December 31, 2027, the equipment was appraised and determined to have a fair value of \$565,000 and \$570,000 respectively; its estimated useful life and residual value did not change.

Which of the following statements is INCORRECT?

Under ASPE, on December 31, 2027 the carrying amount of the equipment will be \$427,500.

Using IAS 16 will result in \$12,500 of additional depreciation expense in 2027.

Under IFRS, the revaluation surplus will cause IFRS-based shareholders' equity to be \$165,000 higher at the end of 2027.

Under ASPE, the depreciation expense in 2026 is \$47,500.

A generic framework for case analysis is recommended not only for integration and analysis cases in an academic setting but can also be applied to business decision-making situations.

Which of the following steps in a case analysis would NOT be appropriate?

Identifying the needs of the users.

Identifying and ranking the issues that must be addressed.

Creating a list of alternatives that are relevant and viable to the situation.

Providing all identified alternatives to the users in the final report.

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

Describe the interrelationships of the financial statement elements and include an example.

X Inc. and Y Inc. are virtually identical companies with identical cost structures and very similar business practices operating in the same lines of business. X Inc. and Y Inc. are both public companies based in Canada and follow IFRS. The following are the condensed income statements for both companies:

	X Inc.	Y Inc.
Sales:	\$1,000,000	\$2,000,000
Less:		
Cost of Goods Sold	<u>500,000</u>	<u>1,600,000</u>
Gross Margin	\$500,000	\$400,000
Administrative Expenses	<u>200,000</u>	<u>300,000</u>
Net Income	<u>\$ 300,000</u>	<u>\$ 100,000</u>

Required: Given the information provided, what are some possible causes for the differing results of these companies?

Briefly discuss the external users need for high-quality financial information.

Explain ways that management can mispresent the financial situation of a company.

Provide the procedures used to analyze a company's financial statements to determine its future prospects.

Answer Key

Test name: Ch1_Modern Advanced Accounting in Canada_11e

FALSE

TRUE

FALSE

Although the titles balance sheet or income statement is recommended in IAS 1, it is not mandatory. Titles such as the statement of financial position or statement of profit or loss are permitted.

D

B

C

C

C

D

C

D

C

A

D

B

A

A

Under ASPE, the depreciation expense is \$47,500 per year $[(\$500,000 - \$25,000)/10 \text{ years}]$. The carrying amount on December 31, 2026 is \$452,500 $(\$500,000 - \$47,500)$. The carrying amount on December 31, 2027 is \$405,000 $(\$452,500 - \$47,500)$.

Under IAS 16, depreciation expense in 2027 is \$60,000 $[(\$565,000 - 25,000)/9]$; therefore, the difference between depreciation under ASPE vs IFRS is \$12,500 $(\$60,000 - \$47,500)$. The revaluation surplus for 2027 is \$165,000 $(\$570,000 - \$405,000)$. The revaluation surplus is reported in OCI each year and is accumulated as a separate component of shareholders' equity.

D

The final report would not have a discussion of alternatives for each issue unless the issue was very contentious. Furthermore, if an alternative was dismissed or determined to be inappropriate, it would be redundant to provide arguments to the users in the final report.

Short Answer

Assets are equal to liabilities plus shareholders' equity. The shareholders' equity is most commonly made up of contributed capital and retained earnings. Retained earnings are cumulative and are increased by an entity's net income (conversely, decreased by an entity's net losses) and decreased by declared dividends. Net income, in simple terms, is revenues less expenses.

As an example, when an expense is incurred, net income will decrease. A decrease to net income will decrease retained earnings which in turn decreases shareholders' equity. If the expense is paid for with cash, cash will decrease which will result in a balanced balance sheet.

Short Answer

There could be many possible explanations for these differing results.

Y Inc.'s net income is \$100,000, compared to X Inc.'s \$300,000. Conversely, Y Inc.'s sales are twice those of X Inc. What is particularly noteworthy is Y Inc.'s 20% gross margin compared to X Inc.'s 50% gross margin. This could be due to the accelerated depreciation (double-declining versus straight-line) on Y Inc.'s depreciable properties. Y Inc. could have also accelerated revenue recognition.

Smoothing practices may have been applied to reduce Y Inc.'s income, and of course, its tax liability. Y Inc.'s income may have been further reduced by higher estimates (for example, bad debt expense, warranty costs, etc.) which are not necessarily be indicative of economic conditions.

If Y Inc. has attempted to distort the real situation, it is possible that Y Inc. may have reported sales that never occurred or reported inventory that does not exist.

Note: The above analysis is not exhaustive. Students may be able to identify other valid differences.

Short Answer

External users require high-quality financial information to enable them to assess the likelihood of making a reasonable return with an acceptable level of risk. It is important that the quality of the financial statements provide useful and reliable information to assess the prospects of future cash flows or future earnings.

The users want the information to accurately represent what has happened during the past period. Distorting the real situation is not a faithful representation of the actual situation. The result is the external users are not able to make appropriate decisions as to whether to increase, decrease or maintain their level of participation with the reporting entity in their capacity as investor, creditor, supplier and/or customer.

Short Answer

Management can represent the financial situation of a company by

- using an accounting method that does not match the actual situation,
- managing earnings by increasing profits by recognizing revenue earlier than usual or delaying the recognition of an expense to a later period,
- not following GAAP for certain transactions or
- reporting fictitious transactions.

Note: Students may be able to provide other methods not listed above.

Short Answer

Procedures to analyze a company's financial statements:

Perform common-size analysis and interpret the results.

Review the accounting policies and estimates used by the company to ensure that they are appropriate.

Adjust the financial statements, as necessary, to use appropriate accounting policies and estimates.

Calculate the ratios for one or more periods.

Compare the ratios to relevant benchmarks.

Interpret the results of the analysis to determine whether they are better, worse or the same as the benchmark.

Decide whether to increase, decrease or maintain the level of participation with the reporting entity.