

Intermediate Accounting (Gordon/Raedy/Sannella)
Chapter 2 Financial Reporting Theory

2.1 Overview of the Conceptual Framework

1) The FASB has taken the conceptual framework to a higher level than the IASB.

Answer: FALSE

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP

AACSB: Application of knowledge

2) U.S. GAAP and IFRS set forth the same objective of financial reporting in their respective conceptual frameworks.

Answer: TRUE

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

3) The conceptual framework indicates that the primary users of financial information are the investors, lenders, and managers.

Answer: FALSE

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

4) The conceptual framework indicates that the primary users of financial information are the investors, lenders, and other creditors.

Answer: TRUE

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

5) Publicly traded U.S. companies are required to comply with IFRS.

Answer: FALSE

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

6) The FASB's decisions are often based on an investor's need to form an opinion about a company's future cash flows.

Answer: TRUE

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

- 7) What is the primary challenge for financial reporting?
- A) to stay relevant to the needs of investors
 - B) to stay relevant to the needs of lenders and creditors
 - C) to stay relevant to the needs of other financial statement users
 - D) both A & B
 - E) all of the above

Answer: D

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP

AACSB: Application of knowledge

- 8) The conceptual framework assists with _____.
- A) the development of a set of standards which provide absolute answers for accounting questions
 - B) the development of a set of standards for auditors to use when looking for material misstatements or fraud
 - C) the development of a set of standards which ensure that financial reports meet the needs of investors and creditors
 - D) All of the above

Answer: C

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP

AACSB: Application of knowledge

- 9) Which of the following types of information is *not* a focus of the primary objective of financial reporting?
- A) information that helps a banker decide to provide a loan
 - B) information that helps a manager assess the efficiency and effectiveness of operations
 - C) information that helps a supplier evaluate amount and timing of cash flows of its customers
 - D) information that helps an investor form an opinion about a company's future cash flows

Answer: D

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

- 10) The primary purpose of financial reporting is to provide information that is useful to a company's _____.
- A) suppliers
 - B) managers
 - C) regulators
 - D) employees

Answer: A

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

11) Which of the following is *not* considered to be a primary user of financial information for which financial reporting standards are designed?

- A) supplier
- B) investor
- C) regulator
- D) lender

Answer: C

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

12) Who are the primary users of financial information? Discuss how FASB and IASB take them into account.

Answer: Primary users are investors, lenders, and other creditors that cannot demand information from the entity. When making decisions regarding the conceptual frameworks, the boards consider the needs of these groups to have access to relevant information when assessing the financial health of a company and in forming opinions about the state of the company.

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP

AACSB: Analytical thinking

13) Ronaldo Woods is a student getting his degree in business administration. He does not like his accounting class very much, and doesn't understand why he needs to study accounting — stating "I'm never going to be an accountant — why do I need to know this?" Explain to Ronaldo why it is important for business students to learn about accounting and give examples.

Answer: Answers will vary — should include discussion on accountability and transparency. Other points could be the need to talk intelligently with their accountant, to know which gauges to watch (and be able to understand their meaning and consequence), and be able to identify economic events that could impact the company. (If open book exam, they could reference the interview with Paul Pacter from Section 2.2.)

Diff: 2

Objective: 2.1

IFRS/GAAP: GAAP

AACSB: Analytical thinking

2.2 The Objective of Financial Reporting

1) Currently the FASB and IASB have two separate conceptual frameworks which are partially converged.

Answer: TRUE

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

2) A purpose of the conceptual framework is to override accounting standards.

Answer: FALSE

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

3) The conceptual framework defines the objective of financial reporting as providing financial information that is useful in making decisions about resource allocation.

Answer: TRUE

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

4) A key relationship among the conceptual framework components is the direct effect of financial reporting standards on the elements of the financial statement.

Answer: FALSE

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

5) A key relationship among the conceptual framework components is the impact the objective of financial reporting has on the qualitative characteristics that are considered to make accounting information useful.

Answer: TRUE

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

6) A purpose of IASB's conceptual framework is to assist preparers, auditors, and users of financial statements.

Answer: TRUE

Diff: 1

Objective: 2.2

IFRS/GAAP: IFRS

AACSB: Analytical thinking

7) A purpose of FASB's conceptual framework is to assist preparers, auditors, and users of financial statements.

Answer: FALSE

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Analytical thinking

8) _____ are identical under U.S. GAAP and IFRS.

A) Elements and Recognition

B) Presentation and Disclosure

C) Objective and Qualitative Characteristics

D) Subjective and Quantitative Characteristics

Answer: C

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

9) Which of the following is *not* a purpose of FASB's conceptual framework?

A) aid in development of new standards

B) support understanding of accounting standards

C) assist with revision of accounting standards

D) override existing accounting standards

Answer: D

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

10) When developing new standards, the standard setters must first determine _____.

A) which elements of the financial statements are affected by the proposed standard

B) if the proposed standard possesses the qualitative characteristics that make accounting information useful

C) if the proposed standard meets the objective of financial reporting

D) which recognition and measurement concepts are used to support the proposed standard

Answer: C

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

11) When developing a new proposed accounting standard, after FASB has determined that the proposed standard meets the objective of financial reporting, the next step in the development process is to _____.

- A) determine which elements of the financial statements are affected by the proposed standard
- B) consider whether the proposed standard possesses the qualitative characteristics that make accounting information useful
- C) weigh constraints on issuing the new standard, which may deter requiring the new standards
- D) identify recognition and measurement concepts used to support the proposed standard

Answer: B

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

12) The primary purpose of the conceptual framework is to provide guidance to _____.

- A) preparers of financial statements
- B) auditors
- C) standard setters
- D) CEOs

Answer: C

Explanation: C) The framework provides some guidance to preparers and auditors, but the best answer would be C, standard setters, as it provides them the most guidance with development of standards.

Diff: 2

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

13) Which of the following best characterizes the current situation concerning revisions to the conceptual framework?

- A) The FASB is considering revisions to their conceptual framework but IASB is not.
- B) The IASB is considering revisions to the conceptual framework but FASB is not.
- C) The FASB and the IASB are working independently on their conceptual frameworks.
- D) The FASB and the IASB are working cooperatively on a single conceptual framework.

Answer: C

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

14) In the conceptual framework, what are the two types of qualitative characteristics of financial reporting?

- A) fundamental and enhancing
- B) point-in-time and period-of-time
- C) recognition and measurement
- D) elements and principles

Answer: A

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

15) In the conceptual framework, what are the two types of elements of financial reporting?

- A) fundamental and enhancing
- B) point-in-time and period-of-time
- C) recognition and measurement
- D) elements and principles

Answer: B

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

16) The IASB and FASB share the goal that standards will be based on an agreed set of fundamental _____.

- A) practices
- B) constraints
- C) standards
- D) concepts

Answer: D

Diff: 2

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

17) All of the following are primary components of the conceptual framework for financial reporting *except* _____.

- A) qualitative characteristics
- B) standards
- C) principles of recognition and measurement
- D) elements

Answer: B

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

18) What is the purpose of the conceptual framework?

Answer: The purpose of the conceptual framework is to establish objectives and fundamental concepts that are the basis for developing and revising financial accounting and reporting standards.

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

19) Discuss how standard setters use the conceptual framework in developing new standards.

Answer: Standard setters will:

- Determine if the proposed standard meets the objective of financial reporting.
- Establish that the information provided by the new standard possesses qualitative characteristics that make accounting information useful.
- Consider the elements of the financial statements affected and the recognition and measurement concepts used to support the new standard.
- Weigh constraints such as the cost and benefit of issuing the new standard, which may deter requiring the new standard.

Diff: 2

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

20) List three active phases in the FASB conceptual framework project.

Answer: Three active phases in the FASB conceptual framework project are:

- Objective and Qualitative Characteristics
- Measurement
- Presentation and Disclosure

Diff: 1

Objective: 2.2

IFRS/GAAP: GAAP

AACSB: Application of knowledge

21) List the three primary components of the conceptual framework for financial reporting and the two subcomponents of each component.

Answer: The primary components of the conceptual framework for financial reporting and related subcomponents are:

- Qualitative characteristics
 - Fundamental characteristics
 - Enhancing characteristics
- Elements
 - Point-in-time elements
 - Period-of-time elements
- Principles
 - Recognition
 - Measurement

Diff: 2

Objective: 2.2

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

2.3 The Qualitative Characteristics of Financial Information

1) The two types of qualitative characteristics are fundamental characteristics and elective characteristics.

Answer: FALSE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

2) The role of qualitative characteristics in the conceptual framework is to increase the decision usefulness of financial information.

Answer: TRUE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

3) Information exhibits the characteristic of faithful representation if it is complete, neutral, and free from error.

Answer: TRUE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

4) Information is relevant if it reliably depicts the substance of an economic event.

Answer: FALSE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

5) Information has predictive value if it provides feedback about prior evaluations.

Answer: FALSE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

6) Information that is not material is never relevant.

Answer: TRUE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

7) Verifiability is a characteristic of faithful representation.

Answer: FALSE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

8) Relevance is an enhancing characteristic of financial information.

Answer: FALSE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

9) Information that is not accurate can be considered faithfully representative.

Answer: TRUE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

10) Materiality cannot always be expressed quantitatively but sometimes requires judgment.

Answer: TRUE

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

11) The two fundamental characteristics of financial information are _____.

A) comparability and understandability

B) relevance and timeliness

C) reliability and faithful representation

D) faithful representation and relevance

Answer: D

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

12) The most important characteristic of accounting information is whether it is _____.

A) free from error

B) material

C) relevant

D) useful

Answer: A

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

13) _____ characteristics distinguish useful financial information from information that is not useful.

- A) Representative
- B) Relevant
- C) Fundamental
- D) Quantitative

Answer: C

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

14) What are the attributes of relevant information?

- A) predictive value, timeliness, free from error
- B) materiality, predictive value, and confirmatory value
- C) comparability, verifiability, and predictive value
- D) complete, neutral, free from error

Answer: B

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

15) Which of the following is *not* a characteristic of relevance?

- A) confirmatory value
- B) materiality
- C) free from error
- D) predictive value

Answer: C

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

16) _____ indicates whether financial information depicts an economic event in a way that is complete, neutral, and free from error.

- A) Relevance
- B) Faithful representation
- C) Verifiability
- D) Truthfulness

Answer: B

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

17) Which of the following is a characteristic of faithful representation?

- A) timely
- B) comparable
- C) material
- D) complete

Answer: D

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

18) The attribute _____ relates to information that is relevant.

- A) comparative value
- B) predictive value
- C) neutrality
- D) verifiability

Answer: B

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

19) All of the following are enhancing characteristics *except* _____.

- A) understandability
- B) verifiability
- C) consistency
- D) comparability

Answer: C

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

20) _____ means that a group of reasonably informed financial statement users are able to reach a consensus decision that reported information is a faithful representation of an underlying economic event.

- A) Comparability
- B) Verifiability
- C) Understandability
- D) Freedom from error

Answer: B

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

21) Financial statements should provide *all* financial information that is relevant and faithfully representative within the limitations of the _____ constraint.

- A) benefit
- B) materiality
- C) usefulness
- D) cost

Answer: D

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

22) Baxter Company issues its annual financial reports within one month of the end of the year. This is an example of which enhancing quality of accounting information?

- A) confirmatory value
- B) relevance
- C) verifiability
- D) timeliness

Answer: D

Diff: 1

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

23) TLR Studio reported earnings per share of \$2.11. This surpassed the average analyst forecast of \$2.06. This information has _____ to users of financial information.

- A) confirmatory value
- B) comparable value
- C) consistent value
- D) both A & C

Answer: A

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

24) Poseidon Corp is aware that a large portion of receivables may become uncollectible because the customer is in talks for bankruptcy. By choosing not to disclose this information, the information provided in the statements _____.

- A) is not verifiable
- B) does not faithfully represent the firm's financial position
- C) both A & B
- D) neither A nor B

Answer: B

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

25) Black Gold Gem Co omitted the fact that a mine has been depleted ahead of estimates. Because of this omission, the financial information provided to users _____.

- A) is not free from error
- B) does not faithfully represent the firm's financial position
- C) both A & B
- D) neither A nor B

Answer: C

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

26) Do you agree or disagree with the following statement: "Financial statements that are free from error are accurate." Explain your answer.

Answer: A financial statement that is free from error is not the same thing as an accurate statement. The nature of accrual accounting is one that relies on estimates; therefore, when saying information reported is free from error, it is really referring to the process used to generate the financial statements being error-free. The amounts reported may be different than the actual amounts in accounts that rely on estimates.

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

27) What is the cost constraint and how does it affect financial reporting?

Answer: The conceptual framework stipulates that standard setters should compare the cost of requiring information to the benefits derived from presenting this information when developing accounting standards. The FASB and the IASB must determine that the costs of implementing a standard will not exceed the benefits that might be derived from it. Standard setters consider costs for both financial statement reporters and users. To be reported, accounting information not only must be relevant and faithfully represented but it also must pass an economic test by satisfying the cost constraint.

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

28) Caesar & Company is planning a major expansion, and is in negotiations with their bank for a loan. The bank requested that Caesar & Co provide them with financial statements as soon as possible after the end of the year. Caesar & Co has several suppliers that are slow to submit invoices, so they are considering making estimates for the amounts associated with those liabilities in order to expedite the preparation of the financial statements for the bank. Discuss the qualitative characteristics that they need to consider.

Answer: This will be a trade-off between verifiability and timeliness. By estimating the amounts for the liabilities, the statements will be less verifiable — because the associated invoices will not be available. However, this will allow them to prepare the statements quickly — and timeliness stipulates that financial information is available to users early enough to assist with decision making.

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

29) Complete the following table — identify which fundamental characteristic and which attribute are indicated in each independent scenario.

Scenario	Fundamental Characteristics	Attribute
TNT Inc.'s accountant has verified that all equipment has been depreciated according to the company's depreciation schedule.		
S & C Company includes in a note all relevant details relating to the company's equipment — including depreciation method, estimated useful life, historical cost, and accumulated depreciation.		
Lindoors Corp discloses plans to dispose of a major operating segment.		
TLR Studios discloses information relating to a pending lawsuit that is likely to have an unfavorable outcome.		

Answer:

Scenario	Fundamental Characteristics	Attribute
TNT Inc.'s accountant has verified that all equipment has been depreciated according to the company's depreciation schedule.	Faithful Representation	Free from error
S & C Company includes in a note all relevant details relating to the company's equipment — including depreciation method, estimated useful life, historical cost, and accumulated depreciation.	Faithful Representation	Complete
Lindoors Corp discloses plans to dispose of a major operating segment.	Relevance	Materiality
TLR Studios discloses information relating to a pending lawsuit that is likely to have an unfavorable outcome.	Faithful Representation	Neutral

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

30) Complete the following table — identify which enhancing characteristic is indicated in each independent scenario and whether it was satisfied or violated.

Scenario	Fundamental Characteristics	Satisfied or Violated
R Hood Corporation reports the historical cost of its archery park on the balance sheet.		
Danios Fishery produces very basic financial statements, without classification or notes. They do have complicated lease and borrowing agreements, and have changed depreciation estimates.		
RR Wood Company switched to fair value accounting for standing timber, which is the method used by most companies in the industry.		
Pets R' Us provides financial statement information every other year.		

Answer:

Scenario	Fundamental Characteristics	Satisfied or Violated
R Hood Corporation reports the historical cost of its archery park on the balance sheet.	Verifiability	Satisfied
Danios Fishery produces very basic financial statements, without classification or notes. They do have complicated lease and borrowing agreements, and have changed depreciation estimates.	Understandability	Violated
RR Wood Company switched to fair value accounting for standing timber, which is the method used by most companies in the industry.	Comparability	Satisfied
Pets R' Us provides financial statement information every other year.	Timeliness	Violated

Diff: 2

Objective: 2.3

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

2.4 Elements of Financial Reporting

1) U.S. GAAP and IFRS identify the same three period-of-time elements.

Answer: FALSE

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

2) U.S. GAAP and IFRS identify the same three point-in-time elements.

Answer: TRUE

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

3) Elements are categorized by whether they are relevant or faithfully representative.

Answer: FALSE

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

4) According to IFRS, point-in-time elements include assets, liabilities, and equity.

Answer: TRUE

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

5) According to IFRS, period-of-time elements include income, expenses, performance, and transactions with owners.

Answer: FALSE

Diff: 1

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

6) Comprehensive income is the residual interest in the assets of an entity that remains after deducting its liabilities.

Answer: FALSE

Diff: 1

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

7) According to U.S. GAAP, period-of-time elements include investments by owners, revenues, comprehensive income, and others.

Answer: TRUE

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

8) IFRS does not treat transactions with owners as separate elements.

Answer: TRUE

Diff: 1

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

9) The IFRS element *capital maintenance* is identical to the GAAP element *comprehensive income*.

Answer: FALSE

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

10) According to IFRS, there are two types of capital maintenance adjustments: financial and physical.

Answer: TRUE

Diff: 2

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

11) Under U.S. GAAP, comprehensive income includes which of the following?

A)

Investments by Owners	Operating Income
No	Yes

B)

Investments by Owners	Operating Income
Yes	No

C)

Investments by Owners	Operating Income
No	No

D)

Investments by Owners	Operating Income
Yes	Yes

Answer: A

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Analytical thinking

12) According to the FASB's conceptual framework, gains include increases in equity from which of the following activities?

A)

Investments by Owners	Peripheral Transactions
Yes	No

B)

Investments by Owners	Peripheral Transactions
Yes	Yes

C)

Investments by Owners	Peripheral Transactions
No	No

D)

Investments by Owners	Peripheral Transactions
No	Yes

Answer: D

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Analytical thinking

13) What is the term that describes the building blocks of the financial statements?

A) fundamental characteristics

B) enhancing characteristics

C) elements

D) assets

Answer: C

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

14) _____ elements appear on the balance sheet.

A) Period-of-time

B) Point-in-time

C) Piece-of-time

D) Phase-in-time

Answer: B

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

15) Under U.S. GAAP, _____ is an example of a period-of-time element and appears on the _____.

- A) accounts receivable, balance sheet
- B) depreciation expense, statement of shareholders' equity
- C) salary payable, balance sheet
- D) sales revenue, income statement

Answer: D

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

16) IFRS and U.S. GAAP both identify assets as _____ elements.

- A) phase-in-time
- B) period-of-time
- C) point-in-time
- D) piece-of-time

Answer: C

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

17) U.S. GAAP identifies _____ point-in-time elements.

- A) two
- B) three
- C) four
- D) five

Answer: B

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

18) U.S. GAAP identifies _____ period-in-time elements.

- A) four
- B) five
- C) six
- D) seven

Answer: D

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

19) IFRS identifies _____ point-in-time elements.

- A) one
- B) three
- C) five
- D) seven

Answer: B

Diff: 1

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

20) IFRS identifies _____ period-in-time elements.

- A) four
- B) five
- C) six
- D) seven

Answer: A

Diff: 1

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

21) Changes in equity that result from the company's central business operations are _____.

- A) revenues and gains
- B) gains and losses
- C) revenues and expenses
- D) losses and expenses

Answer: C

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

22) Which of the following terms describe probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events?

- A) performance
- B) income
- C) equity
- D) asset

Answer: D

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

23) _____ include(s) all changes in equity during a period except those resulting from transactions with owners.

- A) Performance
- B) Revenues
- C) Comprehensive income
- D) Period-of-time elements

Answer: C

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

24) Which element of the financial statements results from peripheral or incidental transactions?

- A) gains
- B) revenues
- C) equity
- D) liabilities

Answer: A

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

25) Which of the following statements is *not* true about distributions to owners?

- A) Distributions to owners represent a decrease in equity.
- B) Distributions to owners result from incurring liabilities.
- C) Distributions to owners are included in other comprehensive income.
- D) Distributions to owners result from rendering services.

Answer: C

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

26) The primary distinction between expenses and losses is _____.

- A) the verifiability of the transactions
- B) the nature of the activities that bring about the transactions
- C) the timing of the transactions
- D) the amount and materiality of the transactions

Answer: B

Diff: 1

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

27) IFRS element *performance* refers to _____.

- A) equity
- B) capital maintenance
- C) profit
- D) revenues and gains

Answer: C

Diff: 1

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

28) The IFRS element *income* relates to which U.S. GAAP element?

- A) comprehensive income
- B) capital maintenance
- C) revenues and expenses
- D) revenues and gains

Answer: D

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

29) The IFRS element *expenses* encompasses which U.S. GAAP elements?

- A) revenues and expenses
- B) losses and expenses
- C) gains and expenses
- D) expenses only

Answer: B

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

30) _____ are restatements or revaluations of reported amounts of assets and liabilities that companies usually report in comprehensive income.

- A) Financial maintenance entries
- B) Capital maintenance adjustments
- C) Physical maintenance entries
- D) Comprehensive maintenance adjustments

Answer: B

Diff: 2

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

31) Under the concept of _____, capital is regarded in terms of the productive capacity of a company.

- A) physical capital maintenance
- B) fiscal capital maintenance
- C) financial capital maintenance
- D) B or C

Answer: A

Diff: 2

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

32) Financial capital maintenance refers to the concept that capital is viewed in terms of _____.

- A) the comprehensive net income
- B) the changes in equity for the period
- C) the monetary investment in the company
- D) the closing cash account

Answer: C

Diff: 2

Objective: 2.4

IFRS/GAAP: IFRS

AACSB: Application of knowledge

33) What is the relationship between the point-in-time elements and the period-of-time elements?

Answer: The period-of-time elements provide a way to describe how the point-in-time elements change during the accounting period.

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Reflective thinking

34) What is equity and how does it change during a period of time?

Answer: Equity is the residual interest in the assets of an entity that remains after deducting its liabilities. It changes when there are investments by the owners, distributions to the owners, increases or decreases in comprehensive income.

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

35) Explain comprehensive income in terms of other elements of the financial statements.

Answer: Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. That is, comprehensive income includes revenues, expenses, gains, and losses, and all other changes to equity not resulting from transactions with the owners.

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Reflective thinking

36) Identify the element, and whether it is point-in-time or period-of-time.

Definition	Element	Point-in-time or Period-of-time
Increases in equity (net assets) from peripheral or incidental transactions and from all other transactions and other events and circumstances affecting the entity with the exception of revenues or investments by owners.		
Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.		
Increases in equity resulting from transfers to it from other entities of something valuable to obtain or increase ownership interests (or equity) in it.		
Outflows or other consumption of assets, incurrence of liabilities, or both — from delivering or producing goods, rendering services, or carrying out other activities that constitute the company's ongoing major or central operations.		

Answer:

Definition	Element	Point-in-time or Period-of-time
Increases in equity (net assets) from peripheral or incidental transactions and from all other transactions and other events and circumstances affecting the entity with the exception of revenues or investments by owners.	Gains	Period-of-time
Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.	Assets	Point-in-time
Increases in equity resulting from transfers to it from other entities of something valuable to obtain or increase ownership interests (or equity) in it.	Investments by Owners	Period-of-time
Outflows or other consumption of assets, incurrence of liabilities, or both — from delivering or producing goods, rendering services, or carrying out other activities that constitute the company's ongoing major or central operations.	Expenses	Period-of-time

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

37) Identify the element, and whether it is point-in-time or period-of-time.

Definition	Element	Point-in-time or Period-of-time
Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.		
Restatements or revaluation of reported amounts of assets and liabilities that companies usually report in comprehensive income.		
The change in equity of a business during a period from transactions and other events and circumstances from nonowner sources.		
The net assets or residual interest in the assets of an entity that remains after deducting its liabilities.		

Answer:

Definition	Element	Point-in-time or Period-of-time
Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.	Liabilities	Point-in-time
Restatements or revaluation of reported amounts of assets and liabilities that companies usually report in comprehensive income.	Capital maintenance adjustments	Period-of-time
The change in equity of a business during a period from transactions and other events and circumstances from nonowner sources.	Comprehensive income	Period-of-time
The net assets or residual interest in the assets of an entity that remains after deducting its liabilities.	Equity	Point-in-time

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

38) Identify the element, and whether it is point-in-time or period-of-time.

Definition	Element	Point-in-time or Period-of-time
Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.		
Decreases in equity resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners.		
Decreases in equity (net assets) from peripheral or incidental transactions and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.		
Inflows or other enhancements of an entity's assets, settlements of liabilities, or both, from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.		

Answer:

Definition	Element	Point-in-time or Period-of-time
Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.	Assets	Point-in-time
Decreases in equity resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners.	Distribution to Owners	Period-of-time
Decreases in equity (net assets) from peripheral or incidental transactions and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.	Losses	Period-of-time
Inflows or other enhancements of an entity's assets, settlements of liabilities, or both, from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.	Revenues	Period-of-time

Diff: 2

Objective: 2.4

IFRS/GAAP: GAAP

AACSB: Application of knowledge

2.5 Principles of Recognition and Measurement

1) The FASB and IASB are converged in general recognition principles.

Answer: FALSE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

2) Recognition is the process of reporting an economic event in the financial statements.

Answer: TRUE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

3) The cost constraint means that an item is not recognized in the financial statements unless its omission would significantly influence the judgment of an informed user.

Answer: FALSE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

4) The major difference between cash and accrual accounting is the timing of revenue and expense recognition.

Answer: TRUE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

5) Revenues are considered earned when a company exchanges a good or service for cash or claims for cash.

Answer: FALSE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

6) Firms change the value of an asset or a liability when expected future cash flows change.

Answer: TRUE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

7) Current cost is the amount of cash received in exchange for an asset less the direct costs of disposal.

Answer: FALSE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

8) U.S. GAAP does not allow companies to prepare financial statements using a cash-basis system.

Answer: TRUE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

9) Quoted prices in active markets are the measure of fair value that is neither the most observable nor the least observable.

Answer: FALSE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

10) Unobservable values cannot be used to report fair value in the financial statements.

Answer: FALSE

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

11) Which of the following is *not* an underlying principle of accrual accounting?

A) measurement

B) monetary unit

C) revenue and expense recognition

D) recognition

Answer: B

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

12) The process of reporting an economic event in the financial statements is known as _____.

A) recording

B) writing

C) recognition

D) transcribing

Answer: C

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

13) Which of the following is *not* one of the four general recognition criteria under U.S. GAAP?

- A) relevant
- B) measurable
- C) reliable
- D) material

Answer: D

Explanation: D) While it is true that there is a materiality threshold which applies to financial information, this is not one of the four general recognition criteria.

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

14) Under IFRS, which of the following is *not* a criteria for recognizing items in the financial statements?

- A) The item is reliable.
- B) The item is relevant.
- C) The item meets the definition of an element.
- D) Economic benefits or costs from the item are probable.

Answer: B

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

15) A Fortune-500 company purchases a new clock which is expected to last for five years for \$35. According to the materiality threshold, this would be treated as an _____ in the accounting records.

- A) asset
- B) expense
- C) equipment
- D) none of the above

Answer: B

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

16) Under U.S. GAAP, it would need to be disclosed that Smith Company is under investigation for bribery charges because of _____.

- A) materiality
- B) the cost constraint
- C) timeliness
- D) reliability

Answer: A

Explanation: A) To ensure transparency, materiality applies to both numerical or nonquantifiable concerns.

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

17) Under IFRS, which of the following is considered to be a measure of current cost?

- A) systematic value
- B) direct cost
- C) present value of future cash flows
- D) historical cost

Answer: C

Diff: 1

Objective: 2.5

IFRS/GAAP: IFRS

AACSB: Application of knowledge

18) Under U.S. GAAP, what is a condition for revenue to be realized or realizable?

- A) Cash or fixed claims to cash are received.
- B) Contracts are written as per negotiations.
- C) The company receives the right to bill with expectation of payment.
- D) Both A & C

Answer: D

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

19) Under U.S. GAAP revenues are considered _____ when the seller has accomplished what it must do to be entitled to the revenues.

- A) recognized
- B) earned
- C) realized
- D) entitled

Answer: B

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

20) IFRS includes all of the following bases of measurement *except* _____.

- A) present value of future cash flows
- B) historical cost
- C) current cost
- D) net realizable value

Answer: C

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

21) Under IFRS income is recognized simultaneously with _____.

- A) increases in assets and increases in liabilities
- B) decreases in assets and increases in liabilities
- C) increases in assets and decreases in liabilities
- D) decreases in assets and decreases in liabilities

Answer: C

Diff: 2

Objective: 2.5

IFRS/GAAP: IFRS

AACSB: Analytical thinking

22) Which of the following is *not* an approach to determine when to report an expense?

- A) systematic allocation
- B) when incurred
- C) matching
- D) net realizable value

Answer: D

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

23) U.S. GAAP identifies _____ measurement bases used in financial reporting and IFRS identifies _____.

- A) three, four
- B) four, five
- C) five, four
- D) four, three

Answer: C

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

24) The _____ cost is the amount of cash (or equivalent) that a firm paid to acquire an asset, whereas _____ is the amount the firm would pay if the asset were purchased today.

- A) historical, current cost
- B) present value, current market value
- C) historical, current market value
- D) realized, present value

Answer: A

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

25) _____ is the amount of cash that the firm actually paid to acquire an asset.

- A) Current market value
- B) Current cost
- C) Historical cost
- D) Net realizable value

Answer: C

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

26) When the buyer and seller are unrelated and independent, the transaction is considered to be _____.

- A) a bad deal
- B) an arms-length transaction
- C) an independent contract
- D) a bribe

Answer: B

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

27) The identified measurement bases are consistent with fair value reporting:

A)

Current market value	Net realizable value
Yes	No

B)

Current market value	Net realizable value
No	No

C)

Current market value	Net realizable value
Yes	Yes

D)

Current market value	Net realizable value
No	Yes

Answer: C

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

28) When deciding how to measure fair value of an asset or liability, there is sometimes a trade-off between _____.

- A) understandability and comparability
- B) faithful representation and neutrality
- C) verifiability and neutrality
- D) relevance and faithful representation

Answer: D

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

29) _____ accounting measures cash receipts and disbursements, leaving out economic activity.

- A) Accrual
- B) Cash-basis
- C) Cloud
- D) Historic

Answer: B

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

30) _____ accounting measures noncash transactions.

- A) Accrual
- B) Cash-basis
- C) Cloud
- D) Historic

Answer: A

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Application of knowledge

31) Purrfect Pets, Inc. provides animal daycare for \$25 per day. Customers buy three month packages, which provide 15 days of care per month. In January they received cash payments from 10 customers. For the month of January, they will recognize _____ of revenue under the cash basis, and _____ of revenue under the accrual basis.

- A) \$375, \$1,125
- B) \$11,250, \$11,250
- C) \$11,250, \$3,750
- D) \$3,750, \$3,750

Answer: C

Explanation: C) Cash basis they recognize the cash received ($\$25 \times 45 \text{ days} \times 100 \text{ customers}$); accrual basis they recognize the revenue of the 15 days of care provided that month ($\$25 \times 15 \text{ days} \times 100 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

32) Purrfect Pets, Inc. provides animal daycare for \$25 per day. Customers buy three month packages, which provide 15 days of care per month. In January, they received cash payments from 10 customers. For the month of February, they will recognize _____ of revenue under the cash basis, and _____ of revenue under the accrual basis.

- A) \$0, \$250
- B) \$3,750, \$3,750
- C) \$250, \$250
- D) \$0, \$3,750

Answer: D

Explanation: D) Cash basis is zero, because no cash was collected during February. Accrual basis they recognize the revenue for the 15 days of care provided that month ($\$25 \times 15 \text{ days} \times 100 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

33) Shadow's Cleaning Service provides weekly cleaning services for \$40 per week. In January, they collected payments from 50 customers for 3 months (12 weeks) of service each. For the month of January they will recognize _____ of revenue under the cash basis, and _____ under the accrual basis.

- A) \$2,000, \$600
- B) \$2,600, \$0
- C) \$8,000, \$2,400
- D) \$24,000, \$8,000

Answer: D

Explanation: D) Using cash basis they recognize what is collected in January ($\$40 \times 12 \text{ weeks} \times 50 \text{ customers}$). Using the accrual basis they recognize what was earned in January ($\$40 \times 4 \text{ weeks} \times 50 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

34) Shadow's Cleaning Service provides weekly cleaning services for \$40 per week. In January, they collected payments from 50 customers for 3 months (12 weeks) of service each. For the month of February they will recognize _____ of revenue under the cash basis, and _____ under the accrual basis.

- A) \$0, \$8,000
- B) \$8,000, \$8,000
- C) \$8,000, \$24,000
- D) \$24,000, \$8,000

Answer: A

Explanation: A) Using cash basis they recognize what is collected in February — which was zero. Using the accrual basis they recognize what was earned in February ($\$40 \times 4 \text{ weeks} \times 50 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

35) TNT Inc charges \$125 per month for a storage unit. In the first quarter of the year, they collected \$6,125. Ten customers pre-paid for three months rental in January, seven customers pre-paid for two months rental in February, and five customers paid for one month in March. Using the cash basis of accounting, TNT will recognize _____ in revenue for January and _____ using the accrual basis.

- A) \$6,125, \$3,750
- B) \$3,750, \$6,125
- C) \$1,250, \$3,750
- D) \$3,750, \$1,250

Answer: D

Explanation: D) Cash basis recognizes the cash collected in January ($\$125 \times 3 \text{ months} \times 10 \text{ people}$).

Accrual recognizes the amount earned in January ($\$125 \text{ for January} \times 10 \text{ people}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

36) TNT Inc charges \$125 per month for a storage unit. In the first quarter of the year, they collected \$6,125. Ten customers pre-paid for three months rental in January, seven customers pre-paid for two months rental in February, and five customers paid for one month in March. Using the cash basis of accounting, TNT will recognize _____ in revenue for February and _____ using the accrual basis.

- A) \$0, \$875
- B) \$875, \$1,750
- C) \$1,750, \$2,125
- D) \$2,125, \$3,000

Answer: C

Explanation: C) Cash basis recognizes cash collected in February ($\$125 \times 2 \text{ months} \times 7 \text{ people}$). Accrual recognizes the amount earned in February ($\$125 \text{ for February} \times 17 \text{ people}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

37) TNT Inc charges \$125 per month for a storage unit. In the first quarter of the year, they collected \$6,125. Ten customers pre-paid for three months rental in January, seven customers pre-paid for two months rental in February, and five customers paid for one month in March. Using the cash basis of accounting, TNT will recognize _____ in revenue for March and _____ using the accrual basis.

- A) \$0, \$3,375
- B) \$625, \$0
- C) \$1,250, \$2,500
- D) \$625, \$2,750

Answer: D

Explanation: D) Cash basis recognizes cash collected in March ($\$125 \times 1 \text{ month} \times 5 \text{ people}$). Accrual recognizes the amount earned in March ($\$125 \text{ for March} \times 22 \text{ people}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

38) Angelo's charges \$200 per month for catering services. In the first quarter of the year, they collected \$14,000. Fifteen customers pre-paid for three months of catering beginning in January, ten customers pre-paid for two months of catering beginning in February, and five customers paid for one month of catering in March. Using the cash basis of accounting, Angelo's will recognize _____ in revenue for January and _____ using the accrual basis.

- A) \$3,000, \$0
- B) \$4,500, \$3,000
- C) \$9,000, \$3,000
- D) \$0, \$9,000

Answer: C

Explanation: C) Cash basis recognizes cash collected in January ($\$200 \times 3 \text{ months} \times 15 \text{ customers}$).

Accrual basis recognizes the amount earned in January ($\$200 \text{ for January} \times 15 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

39) Angelo's charges \$200 per month for catering services. In the first quarter of the year, they collected \$14,000. Fifteen customers pre-paid for three months of catering beginning in January, ten customers pre-paid for two months of catering beginning in February, and five customers paid for one month of catering in March. Using the cash basis of accounting, Angelo's will recognize _____ in revenue for February and _____ using the accrual basis.

- A) \$0, \$3,000
- B) \$4,000, \$5,000
- C) \$3,000, \$6,000
- D) \$4,000, 0

Answer: B

Explanation: B) Cash basis recognizes cash collected in February ($\$200 \times 2 \text{ months} \times 10 \text{ customers}$).

Accrual basis recognizes the amount earned in February ($\$200 \text{ for February} \times 25 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

40) Angelo's charges \$200 per month for catering services. In the first quarter of the year they collected \$14,000. Fifteen customers pre-paid for three months of catering beginning in January, ten customers pre-paid for two months of catering beginning in February, and five customers paid for one month of catering in March. Using the cash basis of accounting, Angelo's will recognize _____ in revenue for January and _____ using the accrual basis.

- A) \$0, \$1,000
- B) \$6,000, \$1,000
- C) \$1,000, \$0
- D) \$1,000, \$6,000

Answer: D

Explanation: D) Cash basis recognizes cash collected in March ($\$200 \times 1 \text{ months} \times 5 \text{ customers}$). Accrual basis recognizes the amount earned in March ($\$200 \text{ for March} \times 30 \text{ customers}$).

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

41) Sydney & Caesar Law Firm uses the cash basis to keep their accounting records. During 2014, they collected \$400,000 from clients. On December 31, 2013 they had accounts receivable of \$60,000. On December 31, 2014 they had accounts receivable of \$80,000 and unearned revenue of \$15,000. Using the accrual basis, how much is Sydney & Caesar Law Firm's service revenue for 2014?

- A) \$340,000
- B) \$395,000
- C) \$405,000
- D) \$420,000

Answer: C

Explanation: C) \$400,000 cash collected - \$60,000 A/R earned in 2013 + \$80,000 A/R earned in 2014 - \$15,000 unearned

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

42) TLR Consulting keep their accounting records using the cash basis. During 2014, they collected \$275,000 from clients. On December 31, 2013 they had accounts receivable of \$50,000 and on December 31, 2014 they had accounts receivable of \$35,000. Additionally, they had unearned revenues of \$7,000. Using the accrual basis of accounting, what did TLR Consulting earn in service fees for 2014?

- A) \$253,000
- B) \$267,000
- C) \$283,000
- D) \$297,000

Answer: A

Explanation: A) \$275,000 cash collected - \$50,000 A/R earned in 2013 + \$35,000 A/R earned in 2014 - \$7,000 unearned

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

43) Dr. Flu uses the cash basis to keep his accounting records. During 2014, he collected \$350,000 from clients. At December 31, 2013 he had accounts receivable of \$100,000. At December 31, 2014 he had accounts receivable of \$125,000 and unearned revenue of \$25,000. What did Dr. Flu earn in service revenue for 2014 using the accrual basis of accounting?

- A) \$275,000
- B) \$300,000
- C) \$325,000
- D) \$350,000

Answer: D

Explanation: D) \$350,000 cash collected - \$100,000 A/R earned in 2013 + \$125,000 A/R earned in 2014 - \$25,000 unearned

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

44) Identify the three main approaches to expense recognition under U.S. GAAP — provide examples of each. How does IFRS expense recognition principles differ?

Answer: Under U.S. GAAP, the three main approaches are to match the expense with the related revenue, to expense it in the period incurred, or to systematically allocate the expense over periods of use. An example of matching the expense to the revenue would be matching the cost of goods sold expense to the related revenue recognized when the inventory is sold. Expensing in the period incurred would be recording supplies expense during the period that they were consumed. Depreciating a piece of equipment over its useful life is an example of systematic allocation. While U.S. GAAP focuses on determining the period when an expense is recognized, IFRS focuses on what expenses are recognized during a period. Specifically, IFRS recognizes all decreases in future economic benefits related to a decrease in an asset or an increase in a liability if can be reliably measured. Thus, the matching principle is not explicitly described as an expense recognition principle because it is subsumed under the other IFRS criteria.

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP/IFRS

AACSB: Analytical thinking

45) What drives the measurement and timing of revenue recognition?

Answer: Companies should recognize revenue to record the transfer of control of goods or services that reflects the consideration to which the company expects to be entitled. This occurs when a company satisfies its performance obligations specified in the contract with a customer.

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Reflective thinking

46) Identify the measurement base described in each definition, then indicate whether it applies to U.S. GAAP, IFRS, or both.

Definition	Measurement Base	U.S. GAAP or IFRS or both
The amount of cash (or equivalent) to be received in exchange for an asset, less the direct costs of disposal. In the case of a liability, it is the amount of cash (or equivalent) expected to be paid to liquidate the obligation, including any direct costs of liquidation.		
The amount of cash (or equivalent) that the firm would receive by selling the asset in an orderly liquidation.		
The amount of cash (or equivalent) that the firm paid to acquire the asset. In the case of a liability, this is the amount that the firm received when it incurred the obligation.		
The amount of cash (or equivalent) that would be required if the firm acquired the asset currently.		

Answer:

Definition	Measurement Base	U.S. GAAP or IFRS or both
The amount of cash (or equivalent) to be received in exchange for an asset, less the direct costs of disposal. In the case of a liability, it is the amount of cash (or equivalent) expected to be paid to liquidate the obligation, including any direct costs of liquidation.	Net realizable value	Both
The amount of cash (or equivalent) that the firm would receive by selling the asset in an orderly liquidation.	Current market value	U.S. GAAP
The amount of cash (or equivalent) that the firm paid to acquire the asset. In the case of a liability, this is the amount that the firm received when it incurred the obligation.	Historical cost	Both
The amount of cash (or equivalent) that would be required if the firm acquired the asset currently.	Current cost	Both

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP/IFRS

AACSB: Application of knowledge

47) Freddie's Fish Store maintains saltwater aquariums for office buildings in Anchorage. The following events occurred during the first two months of 2015. For each event, determine the revenue or expense under the cash and accrual bases of accounting.

- a. In January, Freddie's purchased a new industrial vacuum for cleaning tanks - it is expected to last 5 years, and cost \$5,000.
- b. In January, Freddie's collected \$30,000 prepayment for cleaning services to be completed during January and February.
- c. In February, Freddie's signed a new client, collecting \$6,000 for six months of services.
- d. In February, Freddie's paid its bimonthly utility bill of \$500. They are always billed this amount and pay at the end of the cycle.

Answer:

- a. Cash basis recognize \$5,000 expense; accrual basis will allocate this over 5 years through depreciation expense.
- b. Cash basis recognizes \$30,000 revenue; accrual basis recognizes \$15,000 in January and February.
- c. Cash basis recognizes \$6,000 revenue; accrual basis recognizes \$1,000 for February - July.
- d. Cash basis recognizes \$500 expense; accrual basis recognizes \$250 in January and February.

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

48) Freddie's Fish Store maintains saltwater aquariums for office buildings in Anchorage. The following events occurred during the first two months of 2015. Determine the net income for each month using both the cash and accrual basis. For depreciable items use straight line depreciation with no salvage value.

- a. In January, Freddie's purchased a new industrial vacuum for cleaning tanks - it is expected to last 5 years, and cost \$5,000.
- b. In January, Freddie's collected \$30,000 prepayment for cleaning services to be completed during January and February.
- c. In February, Freddie's signed a new client, collecting \$6,000 for six months of services.
- d. In February, Freddie's paid its bimonthly utility bill of \$500. They are always billed this amount and pay at the end of the cycle.

Answer:

January

Cash basis: revenue \$30,000 - expense \$5,000 = \$25,000

Accrual basis: revenue \$15,000 - expense (\$83.33 depreciation + \$250 utility bill) = \$14,666.67

February

Cash basis: revenue \$6,000 - expense \$500 = \$5,500

Accrual basis: revenue \$16,000 - expense (\$83.33 depreciation + \$250 utility bill) = \$15,666.67

Diff: 2

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

49) Leo's Lounge reported revenue of \$500,000 in its accrual based income statement for the year ended December 31, 2014. Additional information from the books:

Accounts receivable December 31, 2013	\$150,000
Accounts receivable December 31, 2014	310,000
Uncollectible accounts written off during 2014	20,000

What would Leo's revenue be under the cash basis of accounting?

Answer: $\$500,000 + \$150,000 - \$310,000 - \$20,000 = \$320,000$

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

50) Heavenly Honey, Inc. reported revenue of \$250,000 in its accrual based income statement for the year ended December 31, 2014. Additional information from the books:

Accounts receivable December 31, 2013	\$75,000
Accounts receivable December 31, 2014	80,000
Uncollectible accounts written off during 2014	3,000

What would Heavenly Honey's revenue be under the cash basis of accounting?

Answer: $\$250,000 + \$75,000 - \$80,000 - \$3,000 = \$242,000$

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

51) Starlight's Psychic reported revenue of \$200,000 in its cash based income statement for the year ended December 31, 2014. Additional information from the books:

Accounts receivable December 31, 2013	\$10,000
Accounts receivable December 31, 2014	5,000
Prepaid psychic subscription	1,000

What would Starlight's Psychic's revenue be under the accrual basis of accounting?

Answer: $\$200,000 - \$10,000 + \$5,000 - \$1,000 = \$194,000$

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

52) Leonetta's Leather Store reported revenue of \$375,000 in its cash based income statement for the year ended December 31, 2014. Additional information from the books:

Accounts receivable December 31, 2013	\$50,000
Accounts receivable December 31, 2014	75,000
Deposits on custom orders	10,000

What would Leonetta's revenue be under the accrual basis of accounting?

Answer: $\$375,000 - \$50,000 + \$75,000 - \$10,000 = \$390,000$

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

53) S&C Company services elevators at a fee of \$175 per month. Clients pay in advance every quarter - and the company currently services 100 buildings. During the first quarter of the year, S&C collected all service fees on January 1; they also incurred the following expenses: \$8,000 in January, \$15,000 in February, and \$7,000 in March. They paid half of the expense total in February and the rest in March, they did not pay expenses in January. Determine S&C's net income for each month, as well as the quarterly total, under both the cash and accrual basis. Is the quarterly total the same? If it is different, what would account for this?

Answer: The quarterly total is the same.

	Revenue	Recognition	Expense	Recognition	Net Income	Net Income
Month	Cash Basis	Accrual Basis	Cash Basis	Accrual Basis	Cash Basis	Accrual Basis
January	52,500	17,500		8,000	52,500	9,500
February		17,500	15,000	15,000	(15,000)	2,500
March		17,500	15,000	7,000	(15,000)	10,500
Total	52,500	52,500	30,000	30,000	22,500	22,500

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

54) Fanny's Fitness Studio sells memberships at a fee of \$75 per month. Clients pay bimonthly. She currently has 50 clients paying on an even month rotation (February, April, etc.) and 30 clients paying on an odd month rotation (January, March, etc.). Fanny incurs expenses each month for \$100 in electric bills and pays the bill every other month. Determine Fannie's net income for each month for the first quarter of the year, as well as the quarterly total, under both the cash and accrual basis. Is the quarterly total the same? If it is different, what would account for this?

Answer: The quarterly total is different — due to bimonthly collections and payments — the cash based recognizes less revenue and expense during the quarter.

	Revenue	Recognition	Expense	Recognition	Net	Income
Month	Cash Basis	Accrual Basis	Cash Basis	Accrual Basis	Cash Basis	Accrual Basis
January	4,500	6,000	0	100	4,500	5,900
February	7,500	6,000	200	100	7,300	5,900
March	4,500	6,000	0	100	4,500	5,900
Total	16,500	18,000	200	300	16,300	17,700

Diff: 1

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

55) The following events took place at Forrest's Tree Service during the first quarter of the year. Determine Forrest's net income for each month, including a quarterly total, under both the cash and accrual basis of accounting.

- Performed tree services in January - billed clients for \$5,000.
- Monthly saw sharpening - January, February, March - \$500 per month.
- Collected \$2,500 from January clients on February 10th.
- Performed tree services in February - billed clients for \$8,000.
- Employees are paid every other month, salary expense is \$5,000 per month - paid on February 28.
- Performed tree services in March - billed clients for \$10,000 - also collected remaining January balance and \$5,000 due from February.

Answer:

	Revenue	Recognition	Expense	Recognition	Net	Income
Month	Cash Basis	Accrual Basis	Cash Basis	Accrual Basis	Cash Basis	Accrual Basis
January	0	5,000	500	5,500	(500)	(500)
February	2,500	8,000	10,500	5,500	(8,000)	2,500
March	7,500	10,000	500	5,500	7,000	4,500
Total	10,000	23,000	11,500	16,500	(1,500)	6,500

Diff: 3

Objective: 2.5

IFRS/GAAP: GAAP

AACSB: Analytical thinking

2.6 Assumptions in Financial Reporting

1) Like U.S. GAAP, IFRS directly addresses the going concern concept.

Answer: FALSE

Diff: 1

Objective: 2.6

IFRS/GAAP: IFRS

AACSB: Application of knowledge

2) The going concern concept justifies accounting practices such as depreciation.

Answer: TRUE

Diff: 1

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

3) The going concern concept is explicitly stated in the IFRS conceptual framework but not in the U.S. GAAP conceptual framework.

Answer: TRUE

Diff: 1

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

4) The periodicity assumption stipulates that the entity will continue to operate for an indefinite period of time.

Answer: FALSE

Diff: 1

Objective: 2.6

IFRS/GAAP: IFRS

AACSB: Application of knowledge

5) The economic entity concept stipulates that an entity will measure and report economic activities in monetary units.

Answer: FALSE

Diff: 1

Objective: 2.6

IFRS/GAAP: IFRS

AACSB: Application of knowledge

6) Which of the following is *not* an underlying assumption in financial reporting?

A) economic entity concept

B) monetary unit assumption

C) reliability concept

D) periodicity assumption

Answer: C

Diff: 1

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

7) A company reports financial results each year. Which underlying assumption is illustrated by this example?

- A) economic entity concept
- B) going concern concept
- C) monetary unit assumption
- D) periodicity assumption

Answer: D

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

8) The _____ justifies the use of depreciation on buildings.

- A) economic entity concept
- B) monetary unit assumption
- C) going concern concept
- D) historical cost assumption

Answer: C

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

9) The _____ ignores inflation.

- A) economic entity concept
- B) monetary unit assumption
- C) historical cost assumption
- D) business entity concept

Answer: B

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

10) If a company is facing bankruptcy, which underlying assumption would not be valid?

- A) periodicity assumption
- B) economic entity concept
- C) monetary unit assumption
- D) going concern concept

Answer: D

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

11) Classification of assets into current and long-term illustrates which assumption?

- A) going concern concept
- B) economic entity concept
- C) monetary unit assumption
- D) historical cost assumption

Answer: A

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

12) The _____ justifies the use of accrual accounting.

- A) historical cost concept
- B) going concern concept
- C) monetary unit assumption
- D) business entity concept

Answer: B

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

13) Which underlying assumption is violated if the owner's personal residence is included on the company balance sheet?

- A) monetary unit assumption
- B) periodicity assumption
- C) economic entity concept
- D) common sense assumption

Answer: C

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

14) The _____ stipulates that an entity measure and report its economic activities in dollars (or some other monetary unit).

- A) monetary unit assumption
- B) business entity concept
- C) U.S. banking assumption
- D) going concern concept

Answer: A

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

15) Which fundamental characteristic makes explicit the assumption of the full disclosure principle?

- A) relevance
- B) materiality
- C) verifiability
- D) completeness

Answer: D

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

16) Recording online sales transactions in bitcoin currency is a violation of _____.

- A) the business entity concept
- B) common sense
- C) the monetary unit assumption
- D) the going concern concept

Answer: C

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

17) The economic entity concept _____.

- A) stipulates all transactions are stated in economic units
- B) is applicable to all forms of business organizations
- C) requires periodic income measurement
- D) recognizes the legal aspects of business organizations

Answer: B

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

18) Preparation of consolidated financial statements when a parent-subsidary relationship exists is an example of the _____.

- A) monetary unit assumption
- B) periodicity assumption
- C) economic entity concept
- D) common sense assumption

Answer: C

Diff: 2

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Application of knowledge

19) Identify the assumption represented in each scenario, then decide if it is satisfied or violated.

Scenario	Assumption	Satisfied or violated?
Poseidon Corporation is a publicly traded company. They only issue financial statements to external users every other year.		
Charmed Inc. adds land purchased in 2014 to the balance of land purchased in 2000.		
Smith Corp pays the CEO's mortgage and records it as miscellaneous expense.		
Caesar & Company depreciates property, plant, and equipment over their useful lives.		

Answer:

Scenario	Assumption	Satisfied or violated?
Poseidon Corporation is a publicly traded company. They only issue financial statements to external users every other year.	Periodicity	Violated
Charmed Inc. adds land purchased in 2014 to the balance of land purchased in 2000.	Monetary Unit	Satisfied
Smith Corp pays the CEO's mortgage and records it as miscellaneous expense.	Economic Entity	Violated
Caesar & Company depreciates property, plant, and equipment over their useful lives.	Going Concern	Satisfied

Diff: 3

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

20) Identify the assumption represented in each scenario, then decide if it is satisfied or violated.

Scenario	Assumption	Satisfied or violated?
Bettas Inc. adjusted the valuation of balance sheet items to keep up with changes in inflation.		
Sounders Inc. is facing bankruptcy — they choose not to list assets and liabilities at liquidation values on the balance sheet.		
Woods Co. issues quarterly and annual financial statements to external users.		
TNT Studio's president only uses the company limo for business purposes.		

Answer:

Scenario	Assumption	Satisfied or violated?
Bettas Inc. adjusted the valuation of balance sheet items to keep up with changes in inflation.	Monetary Unit	Violated
Sounders Inc. is facing bankruptcy — they choose not to list assets and liabilities at liquidation values on the balance sheet.	Going concern	Violated
Woods Co. issues quarterly and annual financial statements to external users.	Periodicity	Satisfied
TNT Studio's president only uses the company limo for business purposes.	Economic Entity	Satisfied

Diff: 3

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking

21) Identify the assumption represented in each scenario, then decide if it is satisfied or violated.

Scenario	Assumption	Satisfied or violated?
Danios Inc. distributes an annual report to shareholders.		
Illeo Industries does not regularly prepare financial statements.		
Maynard Inc.'s president purchases a car to be used solely for personal purposes with company funds.		
Archer Corporation, a publicly traded U.S. company measures financial elements using the dollar.		

Answer:

Scenario	Assumption	Satisfied or violated?
Danios Inc. distributes an annual report to shareholders.	Going Concern	Satisfied
Illeo Industries does not regularly prepare financial statements.	Periodicity	Violated
Maynard Inc.'s president purchases a car to be used solely for personal purposes with company funds.	Economic Entity	Violated
Archer Corporation, a publicly traded U.S. company measures financial elements using the dollar.	Monetary Unit	Satisfied

Diff: 3

Objective: 2.6

IFRS/GAAP: GAAP

AACSB: Analytical thinking