

CHAPTER 2

CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

CHAPTER LEARNING OBJECTIVES

1. Describe the usefulness of a conceptual framework and the objective of financial reporting.
2. Identify the qualitative characteristics of accounting information and the basic elements of financial statements.
3. Review the basic assumptions of accounting.
4. Explain the application of the basic principles of accounting.

TRUE-FALSE—Conceptual

1. The conceptual framework for accounting has been discovered through empirical research.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

3. The International Accounting Standards Board (IASB) uses a conceptual framework based on individual concepts developed by each member of the standard-setting body.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

4. A soundly developed conceptual framework enables the International Accounting Standards Board (IASB) to issue more useful and consistent pronouncements over time.

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

5. A soundly developed conceptual framework enables the International Accounting Standards Board (IASB) to quickly solve new and emerging practical problems by referencing basic theory.

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

6. The IASB has issued a conceptual framework and has agreed to develop a common conceptual framework with the FASB.

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

7. The International Accounting Standards Board's (IASB's) Conceptual Framework is considered an IFRS.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

8. The International Accounting Standards Board's (IASB's) Conceptual Framework includes the elements of financial statements.

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

9. The 2nd level of the IASB's conceptual framework provides the qualitative characteristics that make accounting information useful and the elements of financial statements.

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

10. One of the challenges in developing a common conceptual framework will be to agree on how the framework should be organized since the FASB and IASB conceptual frameworks are organized in very different ways.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

12. Decision usefulness is the underlying theme of the conceptual framework.

Ans: T

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

13. Users of financial statements are assumed to have no knowledge of business and financial accounting matters by financial statement preparers.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

14. The foundation of the International Accounting Standards Board's (IASB's) Conceptual Framework is found on the third level of the Framework and includes assumptions, principles, and constraints.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

15. An implicit assumption of the International Accounting Standards Board's (IASB's) Conceptual Framework is that users need to be experts in business and financial accounting matters to understand the information contained in financial statements.

Ans: F

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: T

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: T

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

18. Timeliness and neutrality are two ingredients of relevance.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

20. The second level of the International Accounting Standards Board's (IASB's) Conceptual Framework serves as a bridge between the "why" of accounting and the "how" of accounting.

Ans: T

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

21. In the International Accounting Standards Board's (IASB's) Conceptual Framework, qualitative characteristics are considered either relevant or prudent.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

22. In the International Accounting Standards Board's (IASB's) Conceptual Framework, qualitative characteristics distinguish better information from inferior information for decision-making purposes.

Ans: T

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

23. In the International Accounting Standards Board's (IASB's) Conceptual Framework, an enhancing qualitative characteristic is predictive value.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

24. In the International Accounting Standards Board's (IASB's) Conceptual Framework, understandability is an ingredient of one of the fundamental qualitative characteristics.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

25. To be a faithful representation as described by the International Accounting Standards Board's (IASB's) Conceptual Framework, information must be confirmatory.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

26. Comparability is an enhancing quality as described by the International Accounting Standards Board's (IASB's) Conceptual Framework.

Ans: T

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

27. Moon, Inc. applies different accounting treatments to similar events from period to period. Moon, Inc. is violating verifiability as described by the International Accounting Standards Board's (IASB's) Conceptual Framework.

Ans: F

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 1-2

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

28. "Retained earnings" is included as one of the International Accounting Standards Board's (IASB) elements of financial statements.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making
IMA: None

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

Ans: T
LO: 2.3
Bloom: K
Difficulty: Easy
Min: 1
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

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

Ans: F
LO: 2.3
Bloom: K
Difficulty: Easy
Min: 1
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

31. Materiality is one of the basic assumptions of accounting used by the International Accounting Standards Board (IASB).

Ans: F
LO: 2.3
Bloom: K
Difficulty: Easy
Min: 1
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

32. Periodicity is one of the basic assumptions of accounting used by the International Accounting Standards Board (IASB).

Ans: T
LO: 2.3
Bloom: K
Difficulty: Easy
Min: 1
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

33. Timeliness is one of the basic assumptions of accounting used by the International Accounting Standards Board (IASB).

Ans: F

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

34. The periodicity assumption of accounting (used by the International Accounting Standards Board) makes depreciation and amortization policies justifiable and appropriate.

Ans: F

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 1-2

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

35. The IASB conceptual framework specifically identifies accrual basis accounting as one of its fundamental assumptions.

Ans: T

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 1-2

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

36. One assumption made by the IASB conceptual framework is that the reporting entity is a going concern.

Ans: T

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: F

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: T

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: T

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

40. Companies consider only quantitative factors in determining whether an item is material.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

41. The cost constraint requires companies to weigh the costs of providing the information against the benefits that can be derived from using the information.

Ans: T

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

42. Under International Financial Reporting Standards (IFRS) product costs are charged in the immediate period and period costs may be carried into future periods.

Ans: F

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 1-2

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

43. Under International Financial Reporting Standards (IFRS) notes to the financial statements must qualify as an element.

Ans: F

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

44. Under International Financial Reporting Standards (IFRS) supplementary information may be information that is high in relevance but low in reliability.

Ans: T

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

45. The cost constraint included in the International Accounting Standards Board's conceptual framework states that financial information should be free from cost to users of the information.

Ans: F

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

46. The International Accounting Standards Board's (IASB) rule for materiality is any item under 5% of net income is considered immaterial.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

47. The International Accounting Standards Board's (IASB) conceptual framework includes the concept of prudence or conservatism which means when in doubt, choose the solution that will be **least** likely to overstate assets or income and/or understate liabilities or expenses.

Ans: F

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

48. Under International Financial Reporting Standards (IFRS) companies must consider both quantitative and qualitative factors in determining whether an item is material.

Ans: T

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

49. Under International Financial Reporting Standards (IFRS) companies need **not** report immaterial items within the body of the financial statements, but must disclose them in the notes or supplementary information that accompany the financial statements.

Ans: F

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making
IMA: None

50. The conceptual framework underlying U.S. GAAP is similar to that underlying IFRS.

Ans: T

LO: 2.5

Bloom: K

Difficulty: Easy

Min: 1

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

True False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	10.	F	19.	F	28.	F	37.	F	46.	F
2.	T	11.	F	20.	T	29.	T	38.	T	47.	F
3.	F	12.	T	21.	F	30.	F	39.	T	48.	T
4.	T	13.	F	22.	T	31.	F	40.	F	49.	F
5.	T	14.	F	23.	F	32.	T	41.	T	50.	T
6.	T	15.	F	24.	F	33.	F	42.	F		
7.	F	16.	T	25.	F	34.	F	43.	F		
8.	T	17.	T	26.	T	35.	T	44.	T		
9.	T	18.	F	27.	F	36.	T	45.	F		

MULTIPLE CHOICE—Conceptual

51. A soundly developed conceptual framework of concepts and objectives should
- increase financial statement users' understanding of and confidence in financial reporting.
 - enhance comparability among companies' financial statements.
 - allow new and emerging practical problems to be more quickly solved.
 - All of these answers are correct.

Ans: d

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: c

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

53. What is a purpose of having a conceptual framework?
- To make sure that economic activity can be identified with a particular legal entity.
 - To segregate activities among competing companies.

- c. To provide comparable information for different companies.
- d. To enable the profession to more quickly solve emerging practical problems and to provide a foundation from which to build more useful standards.

Ans: d

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

- ^s54. Which of the following is **not** a benefit associated with the IASB Conceptual Framework Project?
- a. A conceptual framework should increase financial statement users' understanding of and confidence in financial reporting.
 - b. Practical problems should be more quickly solvable by reference to an existing conceptual framework.
 - c. A coherent set of accounting standards and rules should result.
 - d. Business entities will need far less assistance from accountants because the financial reporting process will be quite easy to apply.

Ans: d

LO: 2.1

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

55. A soundly developed conceptual framework enables the International Accounting Standards Board (IASB) to
- I. Issue more useful and consistent pronouncements over time.
 - II. More quickly solve new and emerging practical problems by referencing basic theory.
- a. I only.
 - b. II only.
 - c. Both I and II.
 - d. Neither I nor II.

Ans: c

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.1

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

59. The International Accounting Standards Board's (IASB's) Conceptual Framework includes all of the following **except**:
- Objective of financial reporting.
 - Supplementary information
 - Elements of financial statements.
 - Qualitative characteristics of accounting information.

Ans: b

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

60. The second level in the International Accounting Standards Board's (IASB's) Conceptual Framework
- Identifies the objective of financial reporting.
 - Identifies recognition, measurement, and disclosure concepts used in establishing and applying accounting standards.
 - Provides the elements of financial statements.
 - Includes assumptions, principles, and constraints.

Ans: c

LO: 2.1
Bloom: C
Difficulty: Medium
Min: 2-4
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

61. The objective of financial reporting in the International Accounting Standards Board's (IASB's) Conceptual Framework
- Is the foundation for the Framework.
 - Includes the qualitative characteristics that make accounting information useful.
 - Is found on the third level of the Framework.
 - All of the choices are correct regarding the objective of financial reporting.

Ans: a
LO: 2.1
Bloom: K
Difficulty: Easy
Min: 2-4
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

62. An implicit assumption of the International Accounting Standards Board's (IASB's) Conceptual Framework is that
- Information must be decision-useful to all potential users of financial reporting.
 - General-purpose financial reporting is the primary source of information for users of financial reporting.
 - Users need reasonable knowledge of business and financial accounting matters to understand the information contained in financial statements.
 - All of the choices are correct.

Ans: c
LO: 2.1
Bloom: K
Difficulty: Easy
Min: 2-4
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

63. The overriding criterion by which accounting information can be judged is that of
- usefulness for decision making.
 - freedom from bias.
 - timeliness.

d. comparability.

Ans: a

LO: 2.1

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

64. Which of the following is a fundamental quality of useful accounting information?

- a. Comparability.
- b. Relevance.
- c. Neutrality.
- d. Materiality.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

65. Which of the following is a fundamental quality of useful accounting information?

- a. Conservatism.
- b. Comparability.
- c. Faithful representation.
- d. Consistency.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

66. What is meant by comparability when discussing financial accounting information?

- a. Information has predictive or feedback value.
- b. Information is reasonably free from error.
- c. Information that is measured and reported in a similar fashion across companies.
- d. Information is timely.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

68. Which of the following is an ingredient of relevance?

- a. Verifiability.
- b. Timeliness.
- c. Predictive value.
- d. Neutrality.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

69. Which of the following is an ingredient of faithful representation?

- a. Predictive value.
- b. Materiality.
- c. Neutrality.
- d. Confirmatory value.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

70. Company Z has not violated _____ if it changed its method of accounting for inventory after demonstrating the new method is preferable.

- a. Consistency.
- b. Verifiability.
- c. Timeliness.
- d. Comparability.

Ans: a

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

71. Company A issuing its annual financial reports within one month of the end of the year is an example of which enhancing quality of accounting information?

- a. Comparability.

- b. Timeliness.
- c. Understandability.
- d. Verifiability.

Ans: b

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

72. What is the quality of information that is capable of making a difference in a decision?
- a. Faithful representation.
 - b. Materiality.
 - c. Timeliness.
 - d. Relevance.

Ans: d

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

74. Decision makers vary widely in the types of decisions they make, the methods of decision making they employ, the information they already possess or can obtain from other sources, and their ability to process information. Consequently, for information to be useful there must be a linkage between these users and the decisions they make. This link is
- a. relevance.
 - b. faithful representation.

- c. understandability.
- d. materiality.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

75. The two fundamental qualities that make accounting information useful for decision making are
- comparability and timeliness.
 - materiality and neutrality.
 - relevance and faithful representation.
 - faithful representation and comparability.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

77. The quality of information that means the numbers and descriptions match what really existed or happened is
- relevance.
 - faithful representation.
 - completeness.
 - neutrality.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

78. _____ is demonstrated when two independent auditors count a company's inventory and arrive at the same physical quantity amount for inventory.
- Understandability
 - Comparability
 - Neutrality
 - Verifiability

Ans: d

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

79. When information about two different enterprises has been prepared and presented in a similar manner, the information exhibits the characteristic of
- verifiability.
 - faithful representation.
 - confirmatory value.
 - comparability.

Ans: d

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

80. The second level of the International Accounting Standards Board's (IASB's) Conceptual Framework
- focuses on the purpose of financial reporting.
 - defines the ways in which the purpose of financial reporting is implemented.
 - serves as a bridge between the "why" of accounting and the "how" of accounting.
 - all of the choices are correct.

Ans: c

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

81. In the International Accounting Standards Board's (IASB's) Conceptual Framework, qualitative characteristics
- a. Are considered either fundamental or enhancing.
 - b. Contribute to the decision-usefulness of financial reporting information.
 - c. Distinguish better information from inferior information for decision-making purposes.
 - d. All of the choices are correct.

Ans: d

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

82. In the International Accounting Standards Board's (IASB's) Conceptual Framework, an enhancing qualitative characteristic is
- Predictive value.
 - Free from error.
 - Timeliness.
 - Confirmatory value.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

83. In the International Accounting Standards Board's (IASB's) Conceptual Framework, an ingredient of a fundamental qualitative characteristic is
- Neutrality.
 - Verifiability.
 - Timeliness.
 - Understandability.

Ans: a

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

84. In the International Accounting Standards Board's (IASB's) Conceptual Framework, a fundamental qualitative characteristic is
- Materiality.
 - Faithful representation.
 - Decision usefulness.
 - Neutrality.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

85. To be a faithful representation as described by the International Accounting Standards Board's (IASB's) Conceptual Framework, information must be all of the following **except**:
- a. Complete.
 - b. Free from error.
 - c. Confirmatory.
 - d. Neutral.

Ans: c

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

86. Enhancing qualities as described by the International Accounting Standards Board's (IASB's) Conceptual Framework, include all of the following **except**:
- a. Comparability.
 - b. Neutrality.
 - c. Understandability.
 - d. Verifiability.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

87. Erin Company applies the same accounting treatment to similar events from period to period. Erin Company is exhibiting which of the following qualities as described by the International Accounting Standards Board's (IASB's) Conceptual Framework?
- a. Verifiability.
 - b. Consistency.
 - c. Predictive value.
 - d. All of the choices are correct.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

	<u>Moment in Time</u>	<u>Period of Time</u>
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

Ans: a

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

89. Which of the following is **not** a basic element of financial statements?

- Assets.
- Statement of financial position.
- Expenses.
- Income.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

90. Which of the following is a basic element of financial statements that is more associated with the statement of financial position than with the income statement?

- Equity.
- Income.
- Gains.
- Expenses.

Ans: a

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

92. The International Accounting Standards Board (IASB) defines five interrelated elements of financial statements. Which of the following is **not** one of those elements?
- a. Asset.
 - b. Income.
 - c. Equity.
 - d. All of the choices are elements defined by the IASB.

Ans: d

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

93. The International Accounting Standards Board (IASB) defines one of the 5 elements as follows: "the residual interest in the assets of the entity after deducting all its liabilities" Which element matches this description?
- a. Retained earnings.
 - b. Income.
 - c. Equity.
 - d. All of the choices match this definition.

Ans: c

LO: 2.2

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: c

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: b

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

- ^s98. Which of the following basic accounting assumptions is threatened by the existence of severe inflation in the economy?
- Monetary unit assumption.
 - Periodicity assumption.
 - Going-concern assumption.
 - Economic entity assumption.

Ans: a

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

- ^s99. During the lifetime of an entity accountants produce financial statements at artificial points in time in accordance with the concept of

	<u>Relevance</u>	<u>Periodicity</u>
a.	No	No
b.	Yes	No
c.	No	Yes
d.	Yes	Yes

Ans: c

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

100. Under current IFRS, inflation is ignored in accounting due to the
- economic entity assumption.
 - going concern assumption.
 - monetary unit assumption.
 - periodicity assumption.

Ans: c

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

102. Merging the accounting and financial reporting activities for a parent and its subsidiaries is most closely related to the
- economic entity assumption.
 - relevance characteristic.
 - comparability characteristic.
 - neutrality characteristic.

Ans: a

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

103. The periodicity assumption is most closely related to
- the assumption that a company will not be sold or liquidated in the near future.
 - accountants producing financial statements at arbitrary points in time.
 - economic activity being identified with a particular unit of accountability.
 - the idea that money is the common denominator of economic activity.

Ans: b

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

104. The assumption that a company will **not** be sold or liquidated in the near future is known as the
- economic entity assumption.
 - monetary unit assumption.
 - materiality assumption.
 - going concern assumption.

Ans: d

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

105. Which of the following is an implication of the going concern assumption?
- The historical cost principle is credible.

- b. Depreciation and amortization policies are justifiable and appropriate.
- c. The current-noncurrent classification of assets and liabilities is justifiable and significant.
- d. All of these answers are correct.

Ans: d

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

106. The basic assumptions of accounting used by the International Accounting Standards Board (IASB) include all of the following **except**:
- a. Going concern.
 - b. Periodicity.
 - c. Accrual basis.
 - d. Materiality.

Ans: d

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

107. The basic assumptions of accounting used by the International Accounting Standards Board (IASB) include
- a. Neutrality.
 - b. Periodicity.
 - c. Understandability.
 - d. Materiality.

Ans: b

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

108. The basic assumptions of accounting used by the International Accounting Standards Board (IASB) include
- Monetary unit.
 - Decision usefulness
 - Timeliness.
 - All of the choices are basic assumptions of accounting.

Ans: a

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

109. Which of the following basic assumptions of accounting (used by the International Accounting Standards Board) makes depreciation and amortization policies justifiable and appropriate?
- Periodicity.
 - Decision usefulness
 - Monetary unit.
 - Going concern.

Ans: d

LO: 2.3

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making
IMA: None

111. Valuing assets at their liquidation values rather than their cost is **inconsistent** with the
- periodicity assumption.
 - expense recognition principle.
 - materiality equality.
 - historical cost principle.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

112. Revenue is recognized in the accounting period in which the performance obligation is satisfied. This statement describes the
- consistency characteristic.
 - expense recognition principle.
 - revenue recognition principle.
 - relevance characteristic.

Ans: c

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

113. Generally, revenue from sales should be recognized at a point when
- management decides it is appropriate to do so.
 - the product is available for sale to the ultimate consumer.
 - the entire amount receivable has been collected from the customer and there remains no further warranty liability.
 - the performance obligation has been satisfied.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

114. Revenue should be recognized
- at the end of production.
 - at the time of cash collection.
 - when realized.
 - when the performance obligation is satisfied.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

115. The measurement principles reflect a trade-off between
- comparability and consistency.
 - periodicity and the monetary unit assumptions.
 - cash-basis accounting and accrual accounting.
 - relevance and faithful representation.

Ans: d

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

116. Matching efforts with accomplishment is an application of the
- consistency characteristic.
 - expense recognition principle.
 - materiality quality.
 - revenue recognition principle.

Ans: b

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

117. The accounting principle of expense recognition is best demonstrated by
- not recognizing any expense unless some revenue is realized.
 - associating effort (expense) with accomplishment (revenue).
 - recognizing prepaid rent received as revenue.
 - establishing an Appropriation for Contingencies account.

Ans: b

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: c

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

119. Which of the following is an argument against using historical cost in accounting?
- a. Current cost is more relevant.
 - b. Historical cost is based on an exchange transaction.
 - c. Historical cost is reliable.
 - d. Current cost is subjective.

Ans: a

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: b

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

122. A company has a performance obligation when it agrees to
- a. Perform a service for a customer and receives cash payment.
 - b. Sell a product to a customer after receiving payment.

- c. Perform a service or sell a product to a customer.
- d. None of these answers are correct.

Ans: c

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

123. Which of the following is **not** a required component of financial statements prepared in accordance with international financial reporting standards?
- a. President's letter to shareholders.
 - b. Statement of financial position.
 - c. Income statement.
 - d. Notes to financial statements.

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: c

LO: 2.3

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

126. When a cost is difficult to associate with a particular revenue, a company
- a. uses a rational and systematic allocation policy.

- b. may ignore the expense until an association can be developed.
- c. attaches the cost to a product and recognizes it in a subsequent period.
- d. can let the revenue follow the expense.

Ans: a

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

127. Officers' salaries and other administrative expenses are most often
- a. allocated to future periods because of the benefit associated with these costs.
 - b. deferred and reported as an asset on the statement of financial position.
 - c. recognized as a product cost.
 - d. charged to the current period as expenses.

Ans: d

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

129. Which assumption or principle requires that all information significant enough to affect a decision of reasonably informed users should be reported in the financial statements?
- a. Expense recognition.
 - b. Going concern.

- c. Historical cost.
- d. Full disclosure.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

130. The basic principles of accounting used by the International Accounting Standards Board include all of the following **except**:
- a. Measurement
 - b. Full disclosure
 - c. Revenue recognition
 - d. Going concern

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

131. The International Accounting Standards Board has given companies the option of using fair value to report which of the following items?
- a. Receivables
 - b. Investments
 - c. Financial liabilities
 - d. All of the choices can be valued at fair value.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

132. Under International Financial Reporting Standards (IFRS) revenue is recognized
- a. At the time cash is collected.
 - b. During production.
 - c. At the end of production.
 - d. When the performance obligation is satisfied.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

133. Under International Financial Reporting Standards (IFRS) _____ costs are charged off in the immediate period and _____ costs may be carried into future periods.
- Period; product.
 - Material; overhead.
 - Product; period.
 - Overhead; administrative.

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

134. Under International Financial Reporting Standards (IFRS) notes to the financial statements
- Must be quantifiable.
 - Must qualify as an element.
 - Amplify or explain items presented in the main body of the financial statements.
 - All of the choices are correct regarding notes to the financial statements.

Ans: c

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

135. Under International Financial Reporting Standards (IFRS) supplementary information
- May be information that is high in relevance but low in reliability.
 - May include explanations of uncertainties and contingencies.
 - May include descriptions of accounting policies and methods.
 - All of the choices are correct regarding supplementary information.

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: c

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

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

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

139. Which of the following is the first step in the revenue recognition process?
- a. Determine the transaction price.
 - b. Allocate the transaction price to the separate performance obligations.
 - c. Identify the contract with the customer.
 - d. Recognize revenue when a performance obligation is satisfied.

Ans: c

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

140. Expensing the cost of copy paper when the paper is acquired is an example of
- a. Materiality.
 - b. Cost constraint.
 - c. Conservatism.

- d. Industry practices.

Ans: a

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

141. Which of the following would be included in the supplementary information included with the financial statements?

- a. The description of accounting policies used in measuring items reported in the statements.
- b. Explanation of a contingency.
- c. The proven reserves of an oil and gas company.
- d. All of these answer choices would be included in the supplementary information.

Ans: c

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

142. Company A and Company Z sign an agreement that creates enforceable rights or obligations. With which step of revenue recognition is this more closely related?

- a. Recognize revenue when each performance obligation is satisfied.
- b. Allocate the transaction price to the separate performance obligations.
- c. Determine the transaction price.
- d. Identify the contract with the customer.

Ans: d

LO: 2.4

Bloom: C

Difficulty: Medium

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

143. The International Accounting Standards Board's conceptual framework includes a cost constraint. Which of the following best describes the cost constraint?

- a. The benefits of the information must be greater than the costs of providing it.
- b. Financial information should be free from cost to users of the information.

- c. Costs of providing financial information are not always evident or measurable, but must be considered.
- d. All of the choices are correct.

Ans: a

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

144. The International Accounting Standards Board's (IASB) conceptual framework includes a cost-benefit constraint. Which of the following is true regarding this constraint?
- a. Benefits are more difficult to quantify than costs.
 - b. The IASB seeks input on costs and benefits as part of their due process.
 - c. Benefits to preparers may include access to capital at a lower cost.
 - d. All of the choices are correct.

Ans: d

LO: 2.4

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

145. Which of the following is a company-specific aspect of relevance?
- a. Understandability.
 - b. Materiality.
 - c. Verifiability.
 - d. Timeliness.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic

AICPA BB: Strategic/Critical Thinking

AICPA FN: Measurement

AICPA PC: Problem Solving and Decision-making

IMA: None

146. The International Accounting Standards Board's (IASB) conceptual framework
- a. Includes the concept of prudence or conservatism which means when in doubt, choose the solution that will be least likely to overstate assets or income and/or understate liabilities or expenses.
 - b. Includes the concept of cautious prudence which calls for caution when making judgments under conditions of uncertainty.
 - c. Includes the concept of prudence or conservatism which means when in doubt, choose the solution that will be least likely to understate assets or income and/or overstate liabilities or expenses.
 - d. Includes the concept of prudence or conservatism as a desirable, **but not required**, quality of financial reporting information.

Ans: b

LO: 2.2

Bloom: K

Difficulty: Easy

Min: 2-4

AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

147. The International Accounting Standards Board's (IASB) conceptual framework includes which of the following constraints?
- a. Prudence
 - b. Conservatism
 - c. Cost
 - d. All of the choices are constraints in the IASB's conceptual framework.

Ans: c
LO: 2.4
Bloom: K
Difficulty: Easy
Min: 2-4
AACSB: Analytic
AICPA BB: Strategic/Critical Thinking
AICPA FN: Measurement
AICPA PC: Problem Solving and Decision-making
IMA: None

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
51.	d	67.	a	83.	a	99.	c	115.	d	131.	d	147.	c
52.	c	68.	c	84.	b	100.	c	116.	b	132.	d		
53.	d	69.	c	85.	c	101.	d	117.	b	133.	a		
54.	d	70.	a	86.	b	102.	a	118.	c	134.	c		
55.	c	71.	b	87.	b	103.	b	119.	a	135.	a		
56.	d	72.	d	88.	a	104.	d	120.	d	136.	a		
57.	a	73.	a	89.	b	105.	d	121.	b	137.	c		
58.	a	74.	c	90.	a	106.	d	122.	c	138.	d		
59.	b	75.	c	91.	d	107.	b	123.	a	139.	c		
60.	c	76.	b	92.	d	108.	a	124.	d	140.	a		
61.	a	77.	b	93.	c	109.	d	125.	c	141.	c		
62.	c	78.	d	94.	d	110.	a	126.	a	142.	d		
63.	a	79.	d	95.	c	111.	d	127.	d	143.	a		
64.	b	80.	c	96.	b	112.	c	128.	a	144.	d		
65.	c	81.	d	97.	a	113.	d	129.	d	145.	b		
66.	c	82.	c	98.	a	114.	d	130.	d	146.	b		

EXERCISES

Ex. 2-148—Examination of the conceptual framework.

Users of financial statements can face different questions about the recognition and measurement of financial items. To help develop the type of financial information that can be used to answer these questions, financial accounting and reporting rules are based on a conceptual framework.

Instructions

1. What are the basic components of the Conceptual Framework?
2. What are your views about the success of the conceptual framework?

Solution 2-148

1. The basic components of the Conceptual Framework are:
 - a. Objective provides the foundation for the conceptual framework.
 - b. Qualitative characteristics—the characteristics that make accounting information useful.
 - c. Elements—provide the definitions of the broad classifications of items found in financial statements.
 - d. Operational guidelines (recognition, measurement, and disclosure concepts)—recommend concepts to guide decisions concerning the display and disclosure of information about income, cash flows, and financial position. The operational guidelines are composed of three parts:
 - (1) Basic assumptions.
 - (2) Accounting principles.
 - (3) Constraint.
2. In general, the success of the conceptual framework will be determined by its acceptance in practice. The acceptance in practice will be based in large part upon the IASB's solution of practical problems on a timely basis.

It is a matter of opinion and yet to be seen whether or not the conceptual framework will bring about the following benefits.

- a. The IASB should be able to issue more useful and consistent standards in the future.
- b. New practice problems should be solved more rapidly by reference to an existing framework.
- c. Better understanding of and confidence in the financial reporting process by financial statement users should result.
- d. Enhanced comparability among companies' financial statements should result.

LO: 2.1

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement
AICPA PC: Communication
IMA: None

Ex. 2-149—Accounting concepts—identification.

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

1. All payments less than €25 are expensed as incurred.
2. The company employs the same inventory valuation method from period to period.
3. The cost of material and labor for producing a product are carried into the future if the revenue from the product will be recognized in the future.
4. Ability to add 1985 dollar amounts to 2020 dollar amounts without any adjustment.
5. The company president's salary is charged to expense each year.
6. Financial statements are prepared each year.
7. A trade-off is made between sufficient detail and sufficient condensation when preparing financial reports.
8. Personal transactions of the proprietor are distinguished from business transactions.

Solution 2-149

1. Materiality.
2. Comparability (consistency).
3. Expense recognition principle.
4. Monetary unit assumption.
5. Expense recognition principle.
6. Periodicity assumption.
7. Full disclosure principle.
8. Economic entity assumption.

LO: 2.2, 2.3, 2.4

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None

Ex. 2-150—Accounting concepts—identification.

Presented below are a number of accounting procedures and practices for Ramirez Corp. For each of these items, list the assumption, principle, qualitative characteristic, or constraint that is violated.

1. Because the company is attempting to negotiate a loan with the local bank, the financial statements omit information about a lawsuit involving Ramirez Corp.
2. The president of Ramirez Corp. believes it is foolish to report financial information on a yearly basis. Instead, the president believes that financial information should be disclosed only when significant new information is available related to the company's operations.
3. Ramirez Corp. prepared its financial statements by adjusting all Euro amounts to account for inflation.

4. An officer of Ramirez Corp. purchased a new home computer for personal use with company money and charged the computer to Ramirez Corp.'s miscellaneous expense account.

Solution 2-150

1. Neutrality or full disclosure.
2. Periodicity.
3. Monetary unit.
4. Economic entity.

LO: 2.2, 2.3, 2.4

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None

Ex. 2-151—Accounting concepts—matching.

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

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

- _____ 1. Stable-dollar assumption (do not use historical cost principle).
- _____ 2. Key factor is when the performance obligation is satisfied.
- _____ 3. Presentation of error-free information.
- _____ 4. Yearly financial reports.
- _____ 5. Recording annual depreciation.
- _____ 6. Useful standard measuring unit for business transactions.
- _____ 7. Notes as part of necessary information to a fair presentation.
- _____ 8. Affairs of the business distinguished from those of its owners.
- _____ 9. Business enterprise assumed to have a long life.
- _____ 10. Valuing assets at amounts originally paid for them.
- _____ 11. Application of the same accounting principles as in the preceding year.
- _____ 12. Summarizing significant accounting policies.
- _____ 13. Presentation of timely information with predictive and feedback value.

Solution 2-151

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

LO: 2.2, 2.3, 2.4

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None

Ex. 2-152—Accounting concepts—fill in the blanks.

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

1. _____ and _____ are the two fundamental qualities that make accounting information useful for decision making.
2. Information that helps users confirm or correct prior expectations has _____.
3. _____ enables users to identify the real similarities and differences in economic events between different companies.
4. _____ is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
5. Information is _____ if omitting it or misstating it could influence decisions that users make on the basis of the reported financial information.
6. _____ requires that the same accounting method be used from one accounting period to the next.
7. _____ means exercise caution when making judgments under conditions of uncertainty.
8. Providing information that is of sufficient importance to influence the judgment and decisions of an informed user is referred to as _____.
9. Corporations must prepare accounting reports at least yearly due to the _____ assumption.
10. _____ occurs when the performance obligation is satisfied.

Solution 2-152

- | | |
|---------------------------------------|--------------------------------|
| 1. Relevance; faithful representation | 6. Comparability (Consistency) |
| 2. confirmatory value | 7. Cautious prudence |
| 3. Comparability | 8. full disclosure |
| 4. Fair value | 9. periodicity |
| 5. Material | 10. Revenue recognition |

LO: 2.2, 2.3, 2.4

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None

Ex. 2-153—Basic assumptions.

Briefly explain the five basic assumptions that underlie financial accounting.

Solution 2-153

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

LO: 2.3

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None

Ex. 2-154—Historical cost principle.

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

Solution 2-154

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

LO: 2.4

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None

Ex. 2-155—Prudence.

Historically, it has been acceptable practice to invoke the additional constraint of prudence or conservatism as a justification for an accounting treatment under conditions of uncertainty. Discuss prudence or conservatism, the Conceptual Framework, and the IASB's most recent stance on this topic.

Solution 2-155

Prudence or conservatism means the exercise of caution when making decisions under conditions of uncertainty. However, the Conceptual Framework, when updated in 2010, indicated that prudence or conservatism is generally in conflict with the quality of neutrality. This is because being prudent or conservative can lead to bias in the reported financial position and financial performance. In fact, introducing biased understatement of assets (or overstatement of liabilities) in one period frequently leads to overstating financial performance in later periods—a result that cannot be described as prudent and is inconsistent with neutrality (freedom from bias). The Conceptual Framework issued in 2010 did not include prudence or conservatism as desirable qualities for financial reporting.

Subsequently, the IASB was persuaded by arguments that prudence can actually help achieve neutrality when selecting and applying accounting policies. As a result, the IASB reintroduced the term “prudence,” describing it in the 2018 Conceptual Framework as “cautious prudence,” which it says is “the exercise of caution when making judgments under conditions of uncertainty.”

LO: 2.4

Bloom: AP

Difficulty: Medium

Min: 5-8

AACSB: Communication

AICPA BB: Industry/Sector Perspective

AICPA FN: Measurement

AICPA PC: Communication

IMA: None