Chapter 01 Environment and Theoretical Structure of Financial Accounting
Answer Key

True / False Questions

1. The primary function of financial accounting is to provide relevant financial information to parties external to business enterprises.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Easy

2. Accrual accounting attempts to measure revenues and expenses that occurred during accounting periods so they equal net operating cash flow.
FALSE

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Easy

3. The IASB is currently the public sector organization responsible for setting global accounting standards.
FALSE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

4. The Public Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) changed the entity responsible for setting auditing standards in the United States.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

5. A rules-based approach to standard setting stresses professional judgment as opposed to following a list of rules.
FALSE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

6. Standard setters have sometimes changed standards in response to intense political pressure.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

7. The primary responsibility for properly applying accounting standards when communicating with investors and creditors through financial statements lies with a firm's auditors.
FALSE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

8. Auditors play an important role in the resource allocation process by adding credibility to financial statements.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

9. Materiality can be affected by the dollar amount of an item, the nature of the item, or both.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

10. Conservatism is a desired qualitative characteristic of accounting information.
FALSE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

11. Equity is a residual amount representing the owner's interest in the assets of the business after deducting all its liabilities.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

12. Revenues are the increases in economic benefits in the form of increases in assets or decreases in liabilities from activities that constitute the entity's ongoing operations.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

13. Gains or losses result, respectively, from the disposition of business assets for greater than, or less than, their book values.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

14. Comprehensive income is another term for net income.
FALSE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

15. Determining fair value by calculating the present value of future cash flows is a level 1 type of input.
FALSE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Easy

16. The IASB's framework for measuring fair value doesn't change the situations in which fair value is used under current IFRS.
TRUE

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Easy

Matching Questions

17. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. Predictive value	Information is useful in projecting cash flows.	**1**
2. Relevance	Pertinent to the decision at hand.	**2**
3. Distribution to owners	Information is available prior to the decision.	**5**
4. Confirmatory value	Decrease in equity due to transfers to owners.	**3**
5. Timeliness	Information confirms expectations.	**4**

AACSB: Reflective thinking
Bloom's: Comprehension

18. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. Gain	Along with relevance, a fundamental decision-specific quality.	**5**
2. Materiality	Results if an asset is sold for more than book value.	**1**
3. Completeness	Information contains all information necessary for faithful representation.	**3**
4. Comprehensive income	The change in equity from nonowner transactions.	**4**
5. Faithful representation	Concerns the decision-making impact of both the amount and nature of an item.	**2**

AACSB: Reflective thinking
Bloom's: Comprehension

19. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term with their phrases by placing the letter designating the best term in the space provided by the phrase.

1. Neutrality	Important in analysis between firms.	**2**
2. Comparability	Accounting information should be unbiased.	**1**
3. Consistency	The process of including data in financial statements.	**5**
4. Cost effectiveness	Applying the same accounting practices over time.	**3**
5. Recognition	Considers the value of using information relative to cost of providing it.	**4**

AACSB: Reflective thinking
Bloom's: Comprehension

20. Listed below are five terms are followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. Monetary unit assumption	Implies consensus among different observers.	**2**
2. Verifiability	Assumes all transactions can be identified with a particular entity.	**3**
3. Economic entity assumption	Assumes an entity will continue to operate indefinitely.	**4**
4. Going concern assumption	Requires reporting the financial life of an entity in discrete time frames.	**5**
5. Periodicity assumption	Ignores the possibility of inflation.	**1**

AACSB: Reflective thinking
Bloom's: Comprehension

21. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. Historical cost principle	Basis of measurement for fixed assets.	**1**
2. Materiality	Recognition of revenue only after certain criteria are satisfied.	**5**
3. Matching principle	Guide to expense recognition.	**3**
4. Full-disclosure principle	Reporting of all information that could affect decisions.	**4**
5. Revenue recognition	Application of GAAP sometimes avoided under this constraint.	**2**

AACSB: Reflective thinking
Bloom's: Comprehension

22. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. International Accounting Standards Board	It is one of the fundamental qualitative characteristics of financial information.	**3**
2. International Accounting Standards Committee	It developed global accounting standards before the IASB.	**2**
3. Relevance	It develops global accounting standards.	**1**
4. Financial Accounting Standards Board	It has the authority to set U.S. accounting standards.	**5**
5. Securities and Exchange Commission	It develops U.S. GAAP in the U.S.	**4**

AACSB: Reflective thinking
Bloom's: Comprehension

23. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. Expenses	Net assets.	**2**
2. Equity	Outflows of resources to generate revenues.	**1**
3. Distributions to owners	Cash dividends.	**3**
4. Investments by owners	Claims of creditors against the assets of a business.	**5**
5. Liabilities	Transfers of resources in exchange for ordinary and preference shares.	**4**

AACSB: Reflective thinking
Bloom's: Knowledge

24. Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

1. Losses	Net outflows from peripheral transactions.	**1**
2. Assets	Increases in equity from the sale of goods and/or services.	**3**
3. Revenues	Results if an asset is sold for more than book value.	**5**
4. Comprehensive income	All changes in equity except owner transactions.	**4**
5. Gains	Probable future economic benefits controlled by an entity.	**2**

AACSB: Reflective thinking
Bloom's: Knowledge

25. Listed below are ten organizations followed by a list of phrases that describe or characterize the organizations. Match each phrase with the correct organization by placing the letter designating the best term in the space provided by the phrase.

1. SEC	Provides regulatory oversight to the IASB.	**6**
2. FASB	Provides advice to the IASB on agenda and priorities.	**7**
3. IASB	Sets accounting standards in the U.S.	**2**
4. AICPA	Provides timely responses to financial reporting issues.	**5**
5. IFRS Interpretations Committee	The IASB's parent organization.	**10**
6. Monitoring Board	IASB's predecessor.	**8**
7. IFRS Advisory Council	FASB's predecessor.	**9**
8. IASC	Regulates the financial reporting for public companies in the U.S.	**1**
9. APB	Professional organization of certified public accountants in the U.S.	**4**
10. IFRS Foundation	Sets global accounting standards.	**3**

AACSB: Reflective thinking
Bloom's: Knowledge

Multiple Choice Questions

26. External decision makers would not look primarily to financial accounting information to assist them in making decisions on:
A. Granting credit.
B. Capital budgeting.
C. Selecting shares.
D. Mergers and acquisitions.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Easy

27. Corporations issue their shares to the investing public in the:

	Primary market	Secondary market
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Easy

28. The primary focus for financial accounting information is to provide information useful for:

	Investing decisions	Credit decisions
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Easy

29. Which of the following is not true about net operating cash flow?
A. It is the difference between cash receipts and cash disbursements from providing goods and services.
B. It is a measure used in accrual accounting and is recognized as the best predictor of future operating cash flows.
C. Over short periods of time, it may not be indicative of long-run cash-generating ability.
D. It is easy to understand and all information required to measure it is factual.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Medium

30. Which of the following groups is not among financial intermediaries?
A. Mutual fund managers
B. Financial analysts
C. CPAs
D. Credit rating organizations

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Medium

31. Which of the following was the first private sector entity that was formed to develop global accounting standards?
A. Accounting Principles Board
B. International Accounting Standards Committee
C. Financial Accounting Standards Board
D. International Accounting Standards Board

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Medium

32. Which of the following does not apply to secondary markets?
A. Transactions are important to the efficient allocation of resources in our economy.
B. New resources are provided when shares are sold by the corporation to the initial owners.
C. Transactions help to establish market prices for additional shares that may be issued in the future.
D. Many investors might be unwilling to provide resources to corporations if there is no available mechanism for the future sale of their shares and bonds to others.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Medium

33. A cause-and-effect relationship is implicit in the:
A. Revenue recognition criteria.
B. Historical cost principle.
C. Matching principle.
D. Going concern assumption.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

34. The full disclosure principle requires a balance between:
A. Comparability and consistency.
B. Relevance and cost effectiveness.
C. Reliability and neutrality.
D. Timeliness and predictive value.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

35. Which of the following groups is not among the external users for whom financial statements are prepared?
A. Customers
B. Suppliers
C. Employees
D. All of the above are external users of financial statements.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Easy

36. In a recent annual report, Apple Computer reported the following in one of its disclosure notes: "Warranty Expense: The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized." This note exemplifies Apple's use of:
A. Conservatism
B. The matching principle
C. Revenue recognition criteria
D. Economic entity

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Medium

37. IFRS is an abbreviation for:
A. Internal Financial Reporting Standards.
B. International Financial Reports Standards.
C. International Finance Reporting Standards.
D. International Financial Reporting Standards.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

38. The term "IFRS" usually refers to the following types of accounting standards:
A. Conceptual Framework and International Financial Reporting Standards.
B. Interpretations issued by the IFRS Interpretations Committee.
C. International Accounting Standards.
D. All of the above.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

39. What are the International Accounting Standards (IAS)?
A. Accounting standards issued by the IASC which will continue to be effective until the IASB revises or replaces them.
B. Accounting standards issued by the IASB which have been withdrawn or superseded.
C. Accounting interpretations issued by the IFRS Interpretations Committee
D. Accounting standards issued by the IASB.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

40. The IASB's standard-setting due process includes, in the correct order:
A. Exposure draft, research, discussion paper, standards.
B. Research, exposure draft, discussion paper, standards.
C. Research, discussion paper, exposure draft, standards.
D. Discussion paper, research, exposure draft, standards.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

41. Which of the following is *not* a provision of the Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley)? The Act:
A. Changed the entity responsible for setting auditing standards.
B. Increased corporate executive responsibility for financial statements.
C. Limited nonaudit services that can be performed by auditors for audit clients.
D. Changed the entity responsible for setting accounting standards.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

42. CPAs are licensed by:
A. The professional accounting body.
B. The accounting standard setters.
C. The country or state.
D. The IASB.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

43. A firm's comprehensive income always:
A. Is the same as its net income.
B. Is greater than its net income.
C. Is less than its net income.
D. Could be greater than or less than net income.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

44. What is the role of the IFRS Interpretations Committee?
A. Provide funds for the IASB.
B. Provide regulatory oversight of the IASB.
C. Provide interpretations for the application of IFRS.
D. Select the IASB members.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

45. What is the role of the IFRS Advisory Council?
A. Provide advice on improving the IFRS.
B. Provide advice on the selection of IASB members.
C. Provide advice on work agenda and priorities.
D. Provide advice on interpretations of IFRS.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Medium

46. Accounting standard setting has been characterized as:
A. A political process.
B. Using the scientific method.
C. Pure deductive reasoning.
D. Pure inductive reasoning.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

47. The International Accounting Standards Board:
A. Was the predecessor to the IASC.
B. Can overrule the FASB when their policies disagree.
C. Promotes the use of high-quality, understandable global accounting standards.
D. Has its headquarters in Geneva.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

48. The most political issue in the FASB's most recent deliberations and amendments to U.S. GAAP on business combinations was:
A. The negative effects on subsequent earnings of amortizing goodwill if firms were required to use the purchase method of accounting for the combination.
B. The negative effects on subsequent earnings of amortizing goodwill if firms were required to use the pooling method of accounting for the combination.
C. The unrealistic statement of financial position assets that would be created if firms were required to use the purchase method of accounting for the combination.
D. The unrealistic statement of financial position assets that would be created if firms were required to use the pooling method of accounting for the combination.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

49. Which of the following is not a provision of the Public Company Accounting Reform and Investor Protection Act of 2002?
A. Corporate executive accountability.
B. Auditor rotation.
C. Retention of workpapers.
D. All of the above are provisions of the Act.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Easy

50. The two major sets of accounting standards in the world are the IFRS and U.S. GAAP. GAAP is an abbreviation for:
A. Generally authorized accounting procedures.
B. Generally applied accounting procedures.
C. Generally accepted auditing practices.
D. Generally accepted accounting principles.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

51. Which IASB organization raises the funds for the IASB's activities?
A. The IFRS Advisory Council.
B. The Monitoring Board.
C. The IFRS Interpretations Committee
D. The IFRS Foundation.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Easy

52. Which IASB organization enforces the use of IFRS?
A. The International Organization of Securities Commissions.
B. The Securities and Exchange Commission.
C. The Monitoring Board.
D. None of the above.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Medium

53. The most recent example of the political process at work in IASB standard setting is the heated debate that occurred on the issue of:
A. Pension plan accounting.
B. Accounting for business combinations.
C. Fair value accounting for financial assets and liabilities.
D. Accounting for share-based compensation.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

54. The recognition of which of the following expenses exemplifies the application of the matching principle?
A. President's salary.
B. Research and development.
C. Cost of goods sold.
D. Advertising.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

55. The IASB's conceptual framework's qualitative characteristics of accounting information include:
A. Historical cost.
B. Revenue recognition.
C. Faithful representation.
D. Full disclosure.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Easy

56. The IASB's conceptual framework's qualitative characteristics of accounting information include:
A. Full disclosure.
B. Relevance.
C. Going concern.
D. Historical cost.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Easy

57. The conceptual framework's qualitative characteristic of relevance includes:
A. Predictive value.
B. Verifiability.
C. Completeness.
D. Neutrality.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Easy

58. The conceptual framework's qualitative characteristic of faithful representation includes:
A. Predictive value.
B. Neutrality.
C. Confirmatory value.
D. Timeliness.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Easy

59. The conceptual framework's recognition and measurement concepts recognize which of the following as an assumption, rather than a principle?
A. Going concern.
B. Historical cost.
C. Full disclosure.
D. Revenue recognition.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Easy

60. The conceptual framework's recognition and measurement concepts recognize which of the following as a principle, rather than an assumption?
A. Periodicity.
B. Monetary unit.
C. Conservatism.
D. Full disclosure.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Easy

61. Phase A of the new conceptual framework focuses on:
A. Objective and qualitative characteristics.
B. Presentation and disclosure.
C. Recognition and measurement.
D. Elements of financial statements.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Easy

62. The primary objective of financial reporting is to provide useful information to:
A. Management.
B. Capital providers.
C. Regulators.
D. None of the above.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

63. Which of the following consists of only the fundamental qualitative characteristics of financial information?
A. Verifiability and relevance.
B. Comparability and faithful representation.
C. Faithful representation and relevance.
D. Comparability and verifiability.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Medium

64. Which of the following consists of only the enhancing qualitative characteristics of financial information?
A. Faithful representation and verifiability.
B. Comparability and timeliness.
C. Understandability and relevance.
D. Relevance and faithful representation.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework.
Level of Learning: Medium

65. Net income equals:
A. Assets minus liabilities.
B. Revenues minus cost of goods sold.
C. Revenues minus expenses.
D. Cash receipts minus cash payments.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

66. Enhancing qualitative characteristics of accounting information include each of the following except:
A. Timeliness.
B. Materiality.
C. Comparability.
D. Verifiability.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

67. The enhancing qualitative characteristic of understandability means that information should be understood by:
A. Those who are experts in the interpretation of financial information.
B. Those who have a reasonable understanding of business and economic activities.
C. Financial analysts.
D. CPAs.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

68. Fundamental qualitative characteristics of accounting information are:
A. Relevance and comparability.
B. Comparability and consistency.
C. Faithful representation and relevance.
D. Neutrality and consistency.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

69. Enhancing qualitative characteristics of accounting information include:
A. Relevance and comparability.
B. Comparability and timeliness.
C. Understandability and relevance.
D. Neutrality and consistency.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

70. Gains are:
A. Inflows from selling a product or service to a customer.
B. Increases in equity resulting from transfers of assets to the company from owners.
C. Increases in equity from peripheral transactions of an entity.
D. None of the above.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

71. When there is agreement between a measure or description and the phenomenon it purports to represent, information possesses which characteristic?
A. Verifiability.
B. Predictive value.
C. Faithful representation.
D. Timeliness.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

72. Surefeet Corporation changed its inventory valuation method. Which characteristic is jeopardized by this change?
A. Comparability.
B. Faithful representation.
C. Consistency.
D. Feedback value.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

73. Of the following, the most important objective for financial reporting is to provide information useful for:
A. Making decisions.
B. Determining taxable income.
C. Providing accountability.
D. Increasing future profits.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

74. Independent auditors express an opinion on the:
A. Fairness of financial statements.
B. Accuracy of financial statements.
C. Soundness of a company's future.
D. Quality of a company's management.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

75. The key constraint on qualitative characteristics of accounting information is:
A. Timeliness.
B. Cost effectiveness.
C. Neutrality.
D. Materiality.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

76. Elements of financial statements do not include:
A. Monetary unit.
B. Investments by owners.
C. Comprehensive income.
D. Expenses.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Easy

77. According to the conceptual framework, verifiability implies:
A. Legal evidence.
B. Logic.
C. Consensus.
D. Legal verdict.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

78. Inventory was acquired in 2013 at a cost of $40,000. A qualified appraiser placed its value at $48,000, and a recent firm offer for the inventory was for a cash payment of $46,000. The inventory should be reported in the financial statements at:
A. $40,000.
B. $27,000.
C. $46,000.
D. $48,000.

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

79. Maltec Corporation has started placing its quarterly financial statements on its web page, thereby reducing by ten days the time to get information to investors and creditors. The qualitative concept improved is:
A. Comparability.
B. Consistency.
C. Timeliness.
D. Faithful representation.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

80. Recognizing expected losses immediately, but deferring expected gains, is an example of:
A. Materiality.
B. Conservatism.
C. Cost effectiveness.
D. Timeliness.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

81. Change in equity from nonowner sources is:
A. Comprehensive income.
B. Revenues.
C. Expenses.
D. Gains and losses.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

82. The assumption that in the absence of contrary information a business entity will continue indefinitely is the:
A. Periodicity assumption.
B. Entity assumption.
C. Going concern assumption.
D. Historical cost assumption.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Medium

83. Which of the following defines "liabilities"?
A. Decreases in economic benefits that result in decreases in equity.
B. Resource from which future economic benefits are expected to flow to the entity.
C. Increases in economic benefits that result in increases in equity.
D. Present obligation that is expected to result in an outflow of economic benefits.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

84. The possibility that the capital markets' focus on periodic profits may tempt a company's management to bend or even break accounting rules to inflate reported net income is an example of:
A. An ethical dilemma.
B. An accounting theory issue.
C. A technical accounting issue.
D. None of the above is correct.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

85. One of the elements that many believe distinguishes a profession from other occupations is the acceptance by its members of a responsibility for the interests of those it serves, often articulated in:
A. Its conceptual framework.
B. Its code of ethics.
C. Accounting standards.
D. Country laws.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

86. Primecoat Corporation could disseminate its annual financial statements two days earlier if it shifted substantial human resources from other operations to the annual report project. Management decided the value of the earlier report was not worth the added commitment of resources. The concept demonstrated is:
A. Timeliness.
B. Materiality.
C. Relevance.
D. Cost effectiveness.

AACSB: Reflective thinking
Bloom's: Application
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

87. Mega Loan Company has very stringent credit requirements and, accordingly, has negligible losses from uncollectible accounts. The company's independent accountants did not protest when, contrary to IFRS, the company recorded bad debt expense only when specific accounts were determined to be uncollectible, rather than use an allowance for uncollectible accounts. The concept demonstrated is:
A. Comparability.
B. Faithful representation.
C. Cost effectiveness.
D. Materiality.

AACSB: Reflective thinking
Bloom's: Application
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

88. An important argument in support of historical cost information is:
A. Relevance.
B. Predictive quality for future cash flows.
C. Materiality.
D. Verifiability.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Easy

89. If a company has gone bankrupt, its financial statements likely violate:
A. The matching principle.
B. The revenue recognition criteria.
C. The stable monetary unit assumption.
D. The going concern assumption.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Medium

90. Revenue should not be recognized until:
A. The risks and rewards of ownership have transferred from seller to buyer.
B. Contracts have been signed and payment has been received.
C. Work has been performed and customer has been billed.
D. Collection has been made and warrantees have expired.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

91. Which of the following is not an identified valuation technique in IFRS regarding fair value measurement?
A. Cost approach.
B. Market approach.
C. Cost-benefit approach.
D. Income approach.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Easy

92. Disclosure notes to a company's financial statements:
A. Are relatively unimportant facts that don't belong in the basic financial statements.
B. Document the source of financial statement facts, like literary footnotes.
C. Are an integral part of a company's financial statements.
D. Are irrelevant facts that are immaterial in amount.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Easy

93. Which of the following best demonstrates the full disclosure principle?
A. The multi-step income statement.
B. The auditors' report.
C. The company's tax return.
D. Disclosure notes to financial statements.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

94. Four different competent accountants independently agree on the amount and method of reporting an economic event. The concept demonstrated is:
A. Reliability.
B. Comparability.
C. Completeness.
D. Verifiability.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Medium

95. The matching principle is:
A. A valuation method.
B. An expense recognition accounting principle.
C. A cash basis reporting principle.
D. An asset classification procedure.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

96. To meet the needs of full disclosure, companies use supplemental information, including:
A. Parenthetical comments or modifying comments placed on the face of the financial statements.
B. Disclosure notes conveying additional insights about company operations, accounting principles, contractual agreements, and pending litigation.
C. Supplemental financial statements that report more detailed information than is shown in the primary financial statements.
D. All of the above are correct.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

97. Ford Motor Company purchases services from suppliers on account and sells its products to distributors on short-term credit. As a result, do each of these events affect net income faster than they affect net operating cash flows?

	Purchase Services	Sell Products
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

A. Option a
B. Option b
C. Option c
D. Option d

AACSB: Analytic
Bloom's: Analysis
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Hard

Essay Questions

Alpaca Corporation had revenues of $200,000 in its first year of operations. They have not collected on $20,000 of their sales, and still owe $25,000 on $70,000 of merchandise they purchased. The company had no inventory on hand at the end of the year. The company paid $15,000 in salaries. Owners invested $20,000 in the business and $20,000 was borrowed on a five-year note. The company paid $2,000 in interest that was the amount owed for the year, and paid $6,000 for a two-year insurance policy on the first day of business. Alpaca has an effective income tax rate of 40%.

98. Compute net income for the first year for Alpaca Corporation.

Revenues		$200,000
Expenses:		
Cost of goods sold	70,000	
Salaries	15,000	
Interest	2,000	
Insurance	3,000	90,000
Income before tax		110,000
Income tax at 40%		44,000
Net income		$ 66,000

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

99. Compute the cash balance at the end of the first year for Alpaca Corporation.

Cash receipts:		
Sales revenue	$200,000	
Less: Accounts receivable	20,000	$180,000
Owners' investments		20,000
Note payable		20,000
Total receipts		220,000
Cash disbursements:		
Purchases	70,000	
Less: Accounts payable	25,000	$ 45,000
Salaries paid		15,000
Interest paid		2,000
Insurance paid		6,000
Estimated taxes paid		44,000
Total cash disbursements		112,000
Ending cash balance		$108,000

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

Tri Fecta, a partnership, had revenues of $360,000 in its first year of operations. The partnership has not collected on $35,000 of its sales, and still owes $40,000 on $150,000 of merchandise they purchased. There was no inventory on hand at the end of the year. The partnership paid $25,000 in salaries. The partners invested $40,000 in the business and $25,000 was borrowed on a five-year note. The partnership paid $3,000 in interest that was the amount owed for the year and paid $8,000 for a two-year insurance policy on the first day of business.

100. Compute net income for the first year for Tri Fecta.

Revenues		$360,000
Expenses:		
Cost of Goods Sold	$150,000	
Salaries	25,000	
Interest	3,000	
Insurance	4,000	182,000
Net income		$178,000

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

101. Compute the cash balance at the end of the first year for Tri Fecta.

Cash receipts:		
Sales revenue	$360,000	
Less: Accounts receivable	35,000	$325,000
Owners' investments		40,000
Note payable		25,000
Total receipts		390,000
Cash disbursements:		
Purchases	150,000	
Less: Accounts payable	40,000	110,000
Salaries paid		25,000
Interest paid		3,000
Insurance paid		8,000
Total cash disbursements		146,000
Ending cash balance		$244,000

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

The following information ($ in millions) comes from a recent annual report of Amazon.com, Inc.:

Net sales	$10,711
Total assets	4,363
End of year balance in cash	1,022
Total stockholders' equity	431
Gross profit (Sales – Cost of Sales)	2,456
Net increase in cash for the year	9
Operating expenses	2,067
Net operating cash flow	702
Other income (expense), net	(12)

102. Compute Amazon's balance in cash at the beginning of the year.

Beginning balance in Cash + Net increase in Cash = Ending balance in Cash
Therefore, beginning balance in Cash = Ending balance in Cash - Net increase in Cash
= $1,022 - 9 = <u>$1,013</u>

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

103. Compute Amazon's total liabilities at the end of the year.

Total assets = Total liabilities + Total Shareholders' equity
Therefore, Total liabilities = Total assets - Total Shareholders' equity =
$4,363 - 431 = <u>$3,932</u>

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

104. Compute cost of goods sold for the year.

Gross profit = Net sales - Cost of goods sold
Therefore, Cost of goods sold = Net sales - Gross profit
= $10,711 - 2,456 = <u>$8,255</u>

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

105. Compute the income before income tax for Amazon.

Net income = Gross profit - Operating expenses + Other income (expense), net
= $2,456 - 2,067 + (12) = $377

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

106. Compare net income (loss) for the year to net cash flow from operating activities. Why are these amounts different? Briefly explain.

These amounts are different because of the differences between cash and accrual accounting. As opposed to cash flows from operations, net income includes both revenues and expenses the timing of which differs from the timing of certain cash receipts and payments. Examples would be credit sales in which the revenues are recorded before the collection of cash and cost of goods sold in which the expense often is recorded later than the cash payment to the supplier for the merchandise.

AACSB: Analytic, Communications
Bloom's: Comprehension
Learning Objective: 01-02 Explain the difference between cash and accrual accounting.
Level of Learning: Hard

107. For each of the following situations, state whether you agree or disagree with the financial reporting practice employed, and briefly explain the reason for your answer.
1. Cantor Corporation's accountant increased the book value of its inventory from its original cost of $1 million to its recently appraised value of $6 million.
2. Stanton Corporation paid for the personal travel of its chief financial officer and charged travel expense.
3. At the end of its 2013 financial year, Dower Ltd received an order from a customer for $60,000. The merchandise will ship early in 2014. Because the sale was made to a long-time customer and the invoice was paid in 2013, the controller recorded the sale in 2013.
4. In the middle of its 2013 financial year, Sanguinetti Ltd paid $12,000 to its insurance company for one-year comprehensive insurance coverage. Sanguinetti recorded the entire expenditure as an expense in 2013.
5. The Churchill Pharmaceutical Company included a note in its financial statements that described a pending lawsuit against the company.
6. The Daily Corporation, a company whose securities are publicly traded, prepares monthly, quarterly, and annual financial statement for internal use but disseminates to external users only the annual financial statements.

1. Disagree — This is a violation of the historical cost (original transaction value) principle.
2. Disagree — This is a violation of the economic entity assumption.
3. Disagree — This is a violation of the revenue recognition criteria.
4. Disagree — This is a violation of the matching principle.
5. Agree — The company is conforming to the full disclosure principle.
6. Disagree — This is a violation of the periodicity assumption.

AACSB: Analytic
Bloom's: Application
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Hard

The following answers point out the key phrases that should appear in students' answers. They are not intended to be examples of complete student responses. It might be helpful to provide detailed instructions to students on how brief or in-depth you want their answers to be.

108. Identify or define the following terms: a. economic entity, b. going concern.

Economic entity - All economic events can be identified with a particular economic entity.
Going concern- In the absence of information to the contrary, it is anticipated that a business entity will continue to operate indefinitely.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Medium

109. List the four financial statements most frequently provided to external users.

Statement of financial position, Income statement, Statement of cash flows, Statement of changes in shareholders' equity.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-01 Describe the function and primary focus of financial accounting.
Level of Learning: Easy

110. What are the pros and cons of a principles-based approach to standard setting, compared with a rules-based approach?

A principles-based approach emphasizes using professional judgment to interpret broad principles and concepts and apply them to various situations, as opposed to following a list of detailed rules, when choosing the accounting treatment for a transaction.

A principles-based approach may result in a more accurate reflection of the true economic substance of a company's transactions and actual performance in the financial statements, because a focus on professional judgment means a lower likelihood of companies structuring transactions to circumvent the accounting rules, and we are more likely to arrive at an appropriate accounting treatment. A principles-based approach may also result in shorter and less complex standards.

However, the absence of detailed rules in a principles-based approach may open the door to even more abuse, because management can use the latitude provided by objectives to justify their preferred accounting approach. Even in the absence of intentional misuse, reliance on professional judgment might result in different interpretations for similar transactions, raising concerns about comparability and consistency. Also, detailed rules help auditors to withstand pressure from clients who want a more favorable accounting treatment, and help companies ensure that they are complying with accounting standards and avoid litigation.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Medium

111. What is it necessary to develop global accounting standards?

The accounting standards set by the standard setting organizations in various countries are not the same due to differences in legal systems, inflation rate, degrees of sophistication and use of capital markets, use of financial reports by tax or government authorities, and political and economic ties with other countries. These differences affect comparability in financial information and impair the ability of companies to raise capital in international markets. It is also difficult for multinational corporations to comply with a few different sets of accounting standards. These differences also cause problems for investors who are comparing companies whose financial statements are prepared using different standards. Hence, it is necessary to develop global accounting standards to help participants in worldwide capital markets and other users to make economic decisions.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards.
Level of Learning: Medium

112. What is the IFRS Interpretations Committee and what is its purpose?

The IFRS Interpretations Committee consists of 14 individuals with the task of resolving accounting issues that are not specifically addressed by the IFRS, within the framework of existing IFRS, and providing interpretations for the application of existing IFRS. The committee focuses on emerging issues and attempts to reach a consensus, speeding up the standard-setting process.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

113. Accounting standard setting has been characterized as a political process. Discuss this proposition giving an example.

Changes in accounting standards can have significant differential effects on companies, investors, creditors, and other interest groups. The IASB must gauge the economic consequences of a change in accounting standards. The process by which financial accounting standards are created includes public comment and sometimes hearings. Ultimately, a vote must be taken to pass a proposed change in IFRS. For example, accounting for financial instruments and fair value accounting for financial assets and liabilities are examples where accounting practices have been affected by political influences on IFRS.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

114. What are the key provisions of the Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act of 2002?

The act provides for the regulation of auditors and the types of services they furnish to clients, increases accountability of corporate executives, addresses conflicts of interest for auditors and securities analysts, and requires that companies document and assess their internal controls, that auditors express an opinion on management's assessment of internal controls, and requires auditors to express their own opinion on company internal controls.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

115. How does the value of an audit affect financial statements?

Outside auditors add credibility to financial statements, increasing the confidence of capital market participants who rely on financial statements in making investment and credit decisions and recommendations.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Hard

116. What provisions did the Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act of 2002 make for performance of non-audit services by an audit firm?

The law makes it unlawful for the auditors of public companies to perform a variety of non-audit services for audit clients. Prohibited services include bookkeeping, internal audit outsourcing, appraisal or valuation services, and various other consulting services. Other non-audit services, including tax services, require pre-approval by the audit committee of the company being audited.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process.
Level of Learning: Medium

117. Briefly describe the materiality constraint.

Materiality - Information is material if it can have an effect on a decision made by a user. If an item is not material, accounting standards need not be followed. For example, if a large corporation purchased a water cooler for one of its common areas for $120, the amount could be expensed rather than recorded as an asset even though the cooler will be useful for several years. Materiality is a judgment call. Materiality is concerned with both the dollar amount of an item and/or the nature of an item. It would probably be material if Microsoft received $1,000,000 in bribes from the Chinese for its technology. A $1,000,000 write-off of old equipment would probably be immaterial for Microsoft.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-06 Identify the objective of financial reporting, the qualitative characteristics of financial reporting information, and the elements of financial statements.
Level of Learning: Hard

118. Give an example of a violation of the stable monetary unit assumption. How would it affect the quality of financial statement information?

In a place or time in which a country experiences severe inflation, this would violate the assumption that dollar amounts are constantly valued. This would limit the usefulness of adding numbers in financial statements, because (for instance) costs at different times are not comparable without adjusting for changes in purchasing power.

AACSB: Reflective thinking
Bloom's: Comprehension
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Hard

119. Identify or define the following terms: a. periodicity, b. monetary unit.

Periodicity - The life of a company can be divided into artificial time periods to provide timely information to external users.
Monetary unit- In the U.S., financial statement elements should be measured in a particular monetary unit, for example, the dollar or the euro.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-07 Describe the basic assumptions underlying the measurement and reporting of financial statement information.
Level of Learning: Medium

120. Identify or define the following terms: a. historical cost, b. revenue recognition criteria.

Historical cost - Asset and liability measurements should be based on the amount given or received in an exchange transaction.
Revenue recognition criteria - Revenue should be recognized only when it can be measured reliably, it is probable that economic benefits flow to the seller, and risks and rewards of ownership have been transferred.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

121. How does IFRS define fair value?

Fair value is defined as the price that would be received to sell assets or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

AACSB: Reflective thinking
Bloom's: Knowledge
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium

122. Accounting standards have developed over time to reflect changes in the business world as well as changes in our ability to account for such changes. Using the example of marking assets and liabilities to their fair value, explain why you would expect accounting standards to change.

Historically, financial accounting relied on transaction amounts (historical cost) as the fundamental measurement approach for reporting assets and liabilities. As markets have matured, it is more relevant and feasible to report some assets and liabilities at their fair values, particularly if such items have a ready market that is active.

AACSB: Reflective thinking
Bloom's: Synthesis
Learning Objective: 01-08 Describe the recognition, measurement and disclosure concepts that guide accounting practice.
Level of Learning: Medium