CHAPTER 2

CONCEPTUAL FRAMEWORK UNDERLYING FINANCIAL ACCOUNTING

CHAPTER LEARNING OBJECTIVES

1. Describe the usefulness of a conceptual framework.
2. Describe efforts to construct a conceptual framework.
3. Understand the objective of financial reporting.
4. Identify the qualitative characteristics of accounting information.
5. Define the basic elements of financial statements.
6. Describe the basic assumptions of accounting.
7. Explain the application of the basic principles of accounting.
8. Describe the impact that constraints have on reporting accounting information.

TRUE-FALSE—Conceptual

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

2. A conceptual framework is a coherent system of interrelated objectives and fundamentals that can lead to consistent standards.

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

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

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.

6. The IASB has issued a conceptual framework that is broadly consistent with that of the United States.

7. The International Accounting Standards Board's (IASB's) Conceptual Framework includes supplementary information.

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

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

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.

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

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

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

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.

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.

16. Relevance and reliability are the two primary qualities that make accounting information useful for decision making.

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

18. Timeliness and neutrality are two ingredients of relevance.

19. Verifiability and predictive value are two ingredients of reliability.

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.

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

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

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

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

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

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

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.

28. The International Accounting Standards Board's (IASB) definition of retained earnings is "the residual interest in the assets of the entity after deducting all its liabilities."

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

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

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

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

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

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

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

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

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

38. Revenues are realizable when assets received or held are readily convertible into cash or claims to cash.

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

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

41. The International Accounting Standards Board has given companies the option of using fair value to report financial liabilities.

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

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

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

45. The cost-benefit 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.

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

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.

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

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.

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

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
    a. increase financial statement users' understanding of and confidence in financial reporting.
    b. enhance comparability among companies' financial statements.
    c. allow new and emerging practical problems to be more quickly solved.
    d. all of these.

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

53. What is a purpose of having a conceptual framework?
    a. To enable the profession to more quickly solve emerging practical problems.
    b. To provide a foundation from which to build more useful standards.
    c. Neither a nor b.
    d. Both a and b.

S54. Which of the following is **not** a benefit associated with the FASB 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.

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.

56. In the conceptual framework for financial reporting, what provides "the why"--the goals and purposes of accounting?
    a. Measurement and recognition concepts such as assumptions, principles, and constraints
    b. Qualitative characteristics of accounting information
    c. Elements of financial statements
    d. Objective of financial reporting

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

58. What is the objective of financial reporting as indicated in the conceptual framework?
    a. provide information that is useful to those making investing and credit decisions.
    b. provide information that is useful to management.
    c. provide information about those investing in the entity.
    d. All of the above.

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

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

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

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

63. The overriding criterion by which accounting information can be judged is that of
    a. usefulness for decision making.
    b. freedom from bias.
    c. timeliness.
    d. comparability.

64. Which of the following is a fundamental quality of useful accounting information?
    a. Comparability.
    b. Relevance.
    c. Consistency.
    d. Materiality.

65. Which of the following is a fundamental quality of useful accounting information?
    a. Conservatism.
    b. Comparability.
    c. Faithful representation.
    d. Consistency.

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.

67. What is meant by consistency when discussing financial accounting information?
    a. Information that is measured and reported in a similar fashion across points in time.
    b. Information is timely.
    c. Information is measured similarly across the industry.
    d. Information is verifiable.

68. Which of the following is an ingredient of relevance?
    a. Completeness.
    b. Representational faithfulness.
    c. Neutrality.
    d. Predictive value.

69. Which of the following is an ingredient of faithful representation?
    a. Predictive value.
    b. Timeliness.
    c. Neutrality.
    d. Feedback value.

70. Changing the method of inventory valuation should be reported in the financial statements under what qualitative characteristic of accounting information?
    a. Understandability.
    b. Verifiability.
    c. Timeliness.
    d. Comparability.

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. Neutrality.
    b. Timeliness.
    c. Predictive value.
    d. Representational faithfulness.

72. What is the quality of information that enables users to better forecast future operations?
    a. Reliability.
    b. Materiality.
    c. Comparability.
    d. Relevance.

73. Which of the following ingredients of fundamental qualities is part of faithful representation?
    a. Neutrality.
    b. Productive value.
    c. Confirmatory value.
    d. Timeliness.

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. reliability.
    c. understandability.
    d. materiality.

75. The two fundamental qualities that make accounting information useful for decision making are
    a. comparability and consistency.
    b. materiality and timeliness.
    c. relevance and faithful representation.
    d. reliability and comparability.

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

77. The quality of information that gives assurance that it is reasonably free of error and bias
    a. relevance.
    b. faithful representation.
    c. verifiability.
    d. neutrality.

78. Financial information does **not** demonstrate consistency when
    a. firms in the same industry use different accounting methods to account for the same type of transaction.
    b. a company changes its estimate of the salvage value of a fixed asset.
    c. a company fails to adjust its financial statements for changes in the value of the measuring unit.
    d. none of these.

79. When information about two different enterprises has been prepared and presented in a similar manner, the information exhibits the characteristic of
    a. relevance.
    b. reliability.
    c. consistency.
    d. none of these.

80. The second level of the International Accounting Standards Board's (IASB's) Conceptual Framework
    a. provides conceptual building blocks that explain the qualitative characteristics of accounting information.
    b. defines the elements of financial statements.
    c. serves as a bridge between the "why" of accounting and the "how" of accounting.
    d. all of the choices are correct.

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.

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

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

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

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.

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.

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.

S88. According to the IASB Conceptual Framework, the elements—assets, liabilities, and equity—describe amounts of resources and claims to resources at/during a

	Moment in Time	Period of Time
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

89. Which of the following is not a basic element of financial statements?
a. Assets.
b. Statement of financial position.
c. Equity.
d. Income.

90. Which of the following basic elements of financial statements is **not** associated with the statement of financial position?
a. Income.
b. Equity.
c. Liability.
d. Asset.

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

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.

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.

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.

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.

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.

97. Which accounting assumption or principle is being violated if a company provides financial reports in connection with a new product introduction?
    a. Economic entity.
    b. Periodicity.
    c. Revenue recognition.
    d. Full disclosure.

S98. Which of the following basic accounting assumptions is threatened by the existence of severe inflation in the economy?
    a. Monetary unit assumption.
    b. Periodicity assumption.
    c. Going-concern assumption.
    d. Economic entity assumption.

S99. During the lifetime of an entity accountants produce financial statements at artificial points in time in accordance with the concept of

	Objectivity	Periodicity
a.	No	No
b.	Yes	No
c.	No	Yes
d.	Yes	Yes

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

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.

102. Preparation of consolidated financial statements when a parent-subsidiary relationship exists is an example of the
   a. economic entity assumption.
   b. relevance characteristic.
   c. comparability characteristic.
   d. neutrality characteristic.

103. During the lifetime of an entity, accountants produce financial statements at arbitrary points in time in accordance with which basic accounting concept?
   a. Cost/benefit constraint
   b. Periodicity assumption
   c. Materiality constraint
   d. Expense recognition principle

104. The assumption that a business enterprise will **not** be sold or liquidated in the near future is known as the
   a. economic entity assumption.
   b. monetary unit assumption.
   c. materiality assumption.
   d. none of these.

105. Which of the following is an implication of the going concern assumption?
   a. 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 signify-cant.
   d. All of these.

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.

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

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

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

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
   a. verifiable.
   b. relevant.
   c. indicative of the entity's purchasing power.
   d. conservative.

111. Valuing assets at their liquidation values rather than their cost is **inconsistent** with the
   a. periodicity assumption.
   b. matching principle.
   c. materiality constraint.
   d. historical cost principle.

112. Revenue is generally recognized when a sale occurs. This statement describes the
   a. consistency characteristic.
   b. matching principle.
   c. revenue recognition principle.
   d. relevance characteristic.

113. Generally, revenue from sales should be recognized at a point when
   a. management decides it is appropriate to do so.
   b. the product is available for sale to the ultimate consumer.
   c. the entire amount receivable has been collected from the customer and there remains no further warranty liability.
   d. none of these.

114. Revenue generally should be recognized
   a. at the end of production.
   b. at the time of cash collection.
   c. when realized.
   d. when a sale occurs.

115. Which of the following is **not** a time when revenue may be recognized?
   a. At time of sale
   b. At receipt of cash
   c. During production
   d. All of these are possible times of revenue recognition.

116. The Allowance for Doubtful Accounts, which appears as a deduction from Accounts Receivable on a statement of financial position and which is based on an estimate of bad debts, is an application of the
    a. consistency characteristic.
    b. expense recognition principle.
    c. materiality constraint.
    d. revenue recognition principle.

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

118. Application of the full disclosure principle
    a. is theoretically desirable but not practical because the costs of complete disclosure exceed the benefits.
    b. is violated when important financial information is buried in the notes to the financial statements.
    c. is demonstrated by the use of supplementary information presenting the effects of changing prices.
    d. requires that the financial statements be consistent and comparable.

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

120. When is revenue generally recognized?
    a. When cash is received.
    b. When the warranty expires.
    c. When production is completed.
    d. When the sale occurs.

121. Which of the following are the two components of the revenue recognition principle?
    a. Cash is received and the amount is material.
    b. It is probable that future economic benefits will flow to the company and it is possible to reliably measure the amount.
    c. Production is complete and there is an active market for the product.
    d. Cash is realized or realizable and production is complete.

122. Which of the following practices may **not** be an acceptable deviation from recognizing revenue at the point of sale?
    a. Upon receipt of cash.
    b. During production.
    c. Upon receipt of order.
    d. End of production.

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

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.

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

126. Recognition of expense related to amortization of an intangible asset illustrates which principle of accounting?
   a. Expense recognition.
   b. Full disclosure.
   c. Revenue recognition.
   d. Historical cost.

127. When should an expenditure be recorded as an asset rather than an expense?
   a. Never.
   b. Always.
   c. If the amount is material.
   d. When future benefit exits.

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 stock price?
   a. Full disclosure.
   b. Going concern.
   c. Historical cost.
   d. Matching.

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. Matching.
   b. Going concern.
   c. Historical cost.
   d. Full disclosure.

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

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

132. Under International Financial Reporting Standards (IFRS) revenue may be recognized
   a. At the point of sale.
   b. During production.
   c. At the end of production.
   d. All of the choices may be acceptable for revenue recognition under IFRS.

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

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

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

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

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

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

139. Where is materiality **not** used in providing financial information?
  a. Applying the revenue recognition principle.
  b. Determining what items to include in the financial statements.
  c. Applying the going concern assumption.
  d. Determining the level of disclosure.

140. Expensing the cost of copy paper when the paper is acquired is an example of which constraint?
  a. Materiality.
  b. Cost-benefit.
  c. Conservatism.
  d. Industry practices.

141. Charging off the cost of a wastebasket with an estimated useful life of 10 years as an expense of the period when purchased is an example of the application of the
  a. consistency characteristic.
  b. matching principle.
  c. materiality constraint.
  d. historical cost principle.

142. Which of the following statements about materiality is **not** correct?
  a. An item must make a difference or it need not be disclosed.
  b. Materiality is a matter of relative size or importance.
  c. An item is material if its inclusion or omission would influence or change the judgment of a reasonable person.
  d. All of these are correct statements about materiality.

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

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.

145. The International Accounting Standards Board's (IASB) conceptual framework includes a materiality constraint. Which of the following is true regarding this constraint?
a. The IASB's rule for materiality is any item under 5% of net income is considered immaterial.
b. Materiality factors into both internal and external accounting decisions.
c. An item is immaterial if its inclusion or omission would influence or change the judgment of a reasonable person.
d. All of the choices are correct.

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. Excludes the concept of prudence or conservatism because it is inconsistent with neutrality, which encompasses freedom from bias.
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.

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.

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.	d	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.	d	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		

Solutions to those Multiple Choice questions for which the answer is “none of these.”

78. a company changes its inventory method every few years in order to maximize reported income (other answers are possible).
79. comparability.
104. going concern assumption.
113. It is probable that future economic benefits will flow to the company and it is possible to reliably measure the amount.

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 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) Constraints.

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.

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. (Do not use conservatism.)
2. The company employs the same inventory valuation method from period to period.
3. A patent is capitalized and amortized over the periods benefited.
4. Assuming that dollars today will buy as much as ten years ago.
5. Rent paid in advance is recorded as prepaid rent.
6. Financial statements are prepared each year.
7. All significant post-statement of financial position events are reported.
8. Personal transactions of the proprietor are distinguished from business transactions.

Solution 2-149

1. Materiality constraint.
2. Comparability characteristic.
3. Expense recognition principle or going concern assumption.
4. Monetary unit assumption.
5. Expense recognition principle or going concern assumption.
6. Periodicity assumption.
7. Full disclosure principle.
8. Economic entity assumption.

Ex. 2-150—Accounting concepts—identification.

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

1. Because the company's income is low this year, a switch from accelerated depreciation to straight-line depreciation is made this year.
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. decides to establish a large loss and related liability this year because of the possibility that it may lose a pending patent infringement lawsuit. The possibility of loss is considered remote by its attorneys.
4. An officer of Ramirez Corp. purchased a new home computer for personal use with company money, charging miscellaneous expense.

Solution 2-150

1. Comparability.
2. Periodicity.
3. Matching.
4. Economic entity.

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
b. Going concern assumption
c. Monetary unit assumption
d. Periodicity assumption
e. Cost principle
f. Revenue recognition principle
g. Expense recognition principle
h. Full disclosure principle
i. Relevance
j. Faithful representation
k. Comparability

____ 1. Stable-dollar assumption (do not use historical cost principle).
____ 2. It is probable that future economic benefits will flow to the company and it is possible to reliably measure the amount.
____ 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	

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 primary 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 phenomena because the information has been measured and reported in a similar manner for different enterprises.
4. Some costs which give rise to future benefits cannot be directly associated with the revenues they generate. Such costs are allocated in a __________________ and _________________ manner to the periods expected to benefit from the cost.
5. _______________________ would allow the expensing of all repair tools when purchased, even though they have an estimated life of 3 years.
6. ________________________ is the quality of information that lets reasonably informed users see the link between information contained in the financial statements and the decisions they make.
7. ____________________ occurs when independent measures using the same methods, obtain similar results.
8. Parenthetical statement of financial position disclosure of the inventory method utilized by a particular company is an application of the _______________________ principle.
9. Corporations must prepare accounting reports at least yearly due to the _______________ assumption.
10. Recording and reporting inflows at the end of production is an allowable exception to the _________________ principle.

Solution 2-152

1. Relevance; faithful representation
2. confirmatory value
3. Comparability
4. rational; systematic
5. The materiality constraint
6. Understandability
7. Verifiability
8. full disclosure
9. periodicity
10. revenue recognition

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 business enterprise 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 the economic activities of an enterprise can be divided 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.

Ex. 2-154—Revenue recognition.

Revenue is generally recognized at the point of sale. There are three exceptions, however. Name the time for each exception, give two qualifications or criteria for the use of each exception, and give an example for each exception.

Solution 2-154

1. During production. The revenue is known (contract) or dependably estimable. Total costs are estimable or other means are available to estimate progress toward completion. Examples are long-term construction contracts and service-type transactions.
2. At completion. There are quoted prices. Units are interchangeable. There are no significant distribution costs. Examples are precious metals or agricultural products.
3. At collection. There is no reasonable basis for estimating the degree of collectibility. Costs of collection, bad debts, and repossessions are not estimable. Examples are installment sales and cost recovery method.

Ex. 2-155—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 2-155

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.

Ex. 2-156—Matching concept.

A concept is a group of related ideas. Matching could be considered a concept because it includes ideas related to both revenue recognition and expense recognition. Briefly explain the ideas in (a) revenue recognition and (b) expense recognition.

Solution 2-156

(a) The ideas in revenue recognition include the "three R's" and "earned":
1. Revenues are inflows of net assets from delivering or producing goods or services or other earning activities that are the major operations of an enterprise during a period.
2. Recognition is recording and reporting in the financial statements.
3. Revenues are *realized* when goods or services are exchanged for cash or claims to cash.
4. Revenues are *earned* when the earnings process is complete or virtually complete.

The revenue recognition principle is that revenue is recognized when it is probable that future economic benefits will flow to the company and reliable measurement of the amount is possible.

(b) The ideas in expense recognition include "expense" and "matching":
1. Expenses are outflows of net assets during a period from delivering or producing goods or services or other activities that are the major operations of the entity.
2. Expenses are recognized when the goods or services (efforts) make their contribution to revenue.

The expense recognition principle is that expenses are matched with revenues. Expenses are matched three ways:
1. When there is an association with revenue, expenses are matched with revenues in the period the revenues are recognized.
2. When no association with revenue is evident, expenses are allocated on some systematic and rational basis.
3. When no association with revenue is evident and no future benefits are expected, expenses are recognized immediately.