

## **Chapter 2--Financial Reporting: Its Conceptual Framework**

*Student:* \_\_\_\_\_

1. Accounting principles are theories, truths, and propositions that service as the basis for financial accounting and reporting.

True False

2. The rules for accounting are based upon concepts, and principles which broad and subject to an interpretation.

True False

3. Information is communicated to external users by the management of the company. Those users cannot dictate desired financial results to the company.

True False

4. The primary purpose of financial reporting is to provide useful and relevant information to the internal stakeholder's of the company.

True False

5. Management's stewardship is to provide information about how a company's cash flows cause changes in the company's resources and claim's.

True False

6. Liquidity is positively related to financial flexibility but negatively related to risk and return on investments.

True False

7. Relevance and faithful representation are the ultimate objectives of accounting information.

True False

8. To measure assets, liabilities, revenues, expenses, and other elements of the financial statements with the most relevant and faithful measurement available is the mixed attribute measurement model.

True False

9. Oil and gas reserves information would be included within the financial statements.

True False

10. Management discussion and analysis would be included in the supplementary information to the financial statements.

True False

11. The eight phases of the joint FASB and IASB framework project are: 1) objective and qualitative characteristics, 2) elements and recognition, 3) presentation and disclosure, 4) reporting entity, 5) measurement, 6) framework for GAAP hierarchy, 7) applicability to the not-for-profit sector, and 8) any remaining issues needing to be addressed.

True False

12. Three phases of the convergence project were put on hold they were elements and recognition, measurement, and presentation and disclosure.

True False

13. Which of the following statements is *not* true with regard to the benefits derived from the FASB's conceptual framework of accounting?

- A. It serves as a guide in establishing standards for the FASB.
- B. The *Statements of Financial Accounting Concepts* is the primary source of GAAP for accountants.
- C. It establishes the objectives of financial reporting.
- D. It enhances comparability between different company's financial statements.

14. Which of the following items is NOT included in FASB's conceptual framework of accounting theory?

- A. qualities of useful accounting information
- B. fundamental principles and assumptions that guide financial accounting and reporting
- C. objectives of financial reporting
- D. All of these choices are included in the conceptual framework

15. The first part of the conceptual framework project had to do with establishing which projects?

- A. elements
- B. objectives
- C. qualitative characteristics
- D. recognition and measurement

16. The accounting projects portion of the FASB's conceptual framework project deals with

- A. which accounting elements should be reported and how they should be measured
- B. which accounting elements should be reported and where the information should be reported
- C. how the accounting elements should be measured and how information should be displayed in financial reports
- D. when accounting elements should be recognized and how information should be displayed in financial reports

17. The accounting projects portion of the FASB's conceptual framework project deals with all of the following *except*

- A. how elements should be measured
- B. when various elements should be reported
- C. which accounting elements should be reported
- D. how financial reports should be displayed

18. What is the goal of FASB and IASB in the creation of the conceptual framework?

- A. To develop standards that are internally consistent.
- B. To develop standards that are internationally converged.
- C. To develop standards that lead to financial reporting that provides clear consistent information to capital providers.
- D. All of these choices

19. The FASB and IASB concluded that the most general objective of financial reporting is to

- A. provide information useful in the decisions made by external users
- B. meet the needs of internal users
- C. provide information about an entity's earnings
- D. provide information about an entity's cash flows

20. According to GAAP, which is *not* a specific objective?

- A. to provide information about an enterprise's cash flows
- B. to provide information that is useful to present to potential investors, creditors, and other users in making rational investment, credit, and similar decisions
- C. to provide information about an enterprise's comprehensive income and its components
- D. to provide information about an enterprise's economic resources, obligations, and owners' equity

21. Information about comprehensive income is useful to external users for all of the following purposes *except*

- A. evaluating management's performance
- B. examining cash flows for the current period
- C. predicting future income
- D. assessing the risk of lending to the company

22. In its "Objectives of Financial Reporting by Business Enterprises" the FASB identified a variety of primary users including all of the following *except*

- A. internal management
- B. investors
- C. creditors
- D. security analysts

23. Which of the following is a specific objective of financial reporting?

- A. provide information that is useful to investors in making investment decisions
- B. provide information useful in assessing the amounts, timing, and uncertainty of prospective cash receipts
- C. provide information useful in assessing the amounts, timing, and uncertainty of prospective cash inflows
- D. provide information about a company's resources and the claims against the company

24. Accrual accounting relates the financial effects of a company's transactions

- A. so that the costs of nonoperational events are matched to the balance sheet in the period impacted
- B. to the period in which they occur rather than to when the cash receipts or payment occurs
- C. so that the revenue impact of every transaction in a period is properly reflected in the income statement
- D. so that the impact of every transaction is reflected in the statement of cash flows

25. Which of the following statements regarding financial flexibility is true?

- A. It is the ability of a company to provide a return on investment.
- B. It is the ability of a company to take effective actions to insure the return of capital to the company.
- C. It is the ability of a company to take adapt changes in the amounts and timing of cash flows.
- D. It is the ability of a company to maintain a given level of operations.

26. Which of the following types of information was specifically identified by the FASB as being useful in assessing the amounts, timing, and uncertainty of a company's future cash flows?
- A. liquidity
  - B. return of investment
  - C. financial capability
  - D. credit standing
27. When investors and creditors make investment and credit decisions, they need information to assist them in assessing future cash receipts. Their focus is on assessing the potential of generating
- A. a return *of* investment of capital
  - B. a return *on* investment of capital
  - C. both a return *of* and a return *on* investment of capital
  - D. neither a return *of* nor a return *on* investment of capital
28. Which qualitative characteristic is an ingredient of relevance?
- A. understandability
  - B. materiality
  - C. neutrality
  - D. representational faithfulness
29. According to the FASB hierarchy of fundamental qualitative characteristics, the two primary qualities making accounting information useful are
- A. understandability and decision usefulness
  - B. relevance and faithful representation
  - C. verifiability and neutrality
  - D. predictive value and feedback value
30. Which fundamental characteristic is an ingredient of faithful representation?
- A. predictive value
  - B. confirmatory value
  - C. timeliness
  - D. neutrality
31. In order to be relevant, accounting information should have
- A. timeliness
  - B. verifiability
  - C. confirmatory value
  - D. All of these choices

32. Which of the following fundamental qualitative characteristics may have to be sacrificed in order to achieve timeliness?
- A. relevance
  - B. verifiability
  - C. comparability
  - D. predictive value
33. What is the ultimate objective of accounting information?
- A. faithful representation
  - B. decision usefulness
  - C. relevance
  - D. predictive value
34. Which of the following are considered enhancing characteristics of accounting information?
- A. verifiability and confirmatory value
  - B. predictive value and timeliness
  - C. comparability and consistency
  - D. representational faithfulness and neutrality
35. A constraint mentioned by GAAP on qualitative characteristics is
- A. understandability
  - B. timeliness
  - C. faithful representation
  - D. benefits greater than costs
36. Which of the following items would most likely be a violation of the materiality constraint?
- A. A company did not separately report an unusual gain of \$100,000. Its income from operations was \$20,000,000.
  - B. A company having reported total assets of \$50,000,000 immediately expensed the purchase of 20 pencil sharpeners that have an estimated useful life of three years.
  - C. A \$75,000 illegal bribe by an executive of the company to a foreign official was not separately disclosed in the annual report.
  - D. A \$2,000 expenditure to improve a building that originally cost \$10,000,000 was immediately expensed.

37. The IASB and FASB boards have agreed that the objective of general purpose financial reporting is to provide

- A. financial information about a company that is useful to investors, lenders and other creditors
- B. mainly cash flow information about a company that is useful to external users in making decisions in their capacity as capital providers
- C. financial information about a company that is useful to internal users in making decisions in their capacity as capital custodians
- D. financial information about a company that is used by government regulators for taxation

38. Similar to the constraints in the FASB's qualitative characteristics, the joint IASB/FASB boards have identified which constraint

- A. consistency
- B. benefits that justify the costs
- C. materiality
- D. objectivity

39. Long Corporation has adopted the policy of charging to expense at the time of purchase all assets having a cost of less than \$200, regardless of the life expectancy of the asset. This policy is most closely related to the

- A. historical cost principle
- B. period-of-time assumption
- C. verifiability principle
- D. materiality principle

40. Intracompany comparability would be violated if

- A. a company used LIFO as its inventory cost method while other companies in the same industry used FIFO
- B. a company changed its bad debts expense estimate from one percent to two percent
- C. a bank did not classify its assets as current assets and noncurrent assets
- D. a company expenses all expenditures of less than \$500 even if the expenditures result in probable future economic benefit

41. Understandability is a characteristic that is

- A. a secondary and interactive quality
- B. a threshold for recognition
- C. an overall quality
- D. an enhancing quality

42. The materiality of an item of financial information refers to the likelihood that its omission or misstatement would affect the decisions of those relying on that information and thus make differing choices if the information had been presented. This concept most closely relates to the

- A. financial magnitude of the item
- B. verifiability of the item
- C. neutrality of the item
- D. confirmatory value of the item

43. All of the following items are classified as accounting assumptions and conventions *except* for

- A. going concern
- B. timeliness
- C. monetary unit
- D. reporting entity

44. The city of Anchorage sold land for its appraised value to the Big Bear Oil Company on June 1, 2014, that originally cost the city \$950,000. On June 1, 2014, the land was appraised at a value of \$1,400,000, and on December 31, 2014, the land's value was estimated to be \$1,450,000. On Big Bear Oil Company's balance sheet at December 31, 2014, the land should be valued at

- A. \$1,400,000
- B. \$1,450,000
- C. \$950,000
- D. \$ 0

45. Using the straight-line method to amortize patents is an application of expense recognition using

- A. cause and effect
- B. a systematic and rational allocation over time
- C. immediate consumption
- D. the percentage-of-completion method

46. Using an allowance method of accounting to recognize uncollectible accounts receivable is an application of which accounting convention?

- A. revenue recognition
- B. historical cost
- C. matching principle
- D. period of time



47. The state legislature is currently debating a bill that, if passed, would require the Roberts Company to go out of business. Which of the following principles or assumptions related to the preparation of Roberts financial statements is most directly affected by this impending vote of the legislature?

- A. going concern
- B. verifiability principle
- C. entity concept
- D. materiality concept

48. A company that uses accounting methods in preparing its tax returns that differ from the accounting methods used to prepare its financial statements is

- A. in violation of the consistency principle
- B. not necessarily violating either the income tax laws or generally accepted accounting principles
- C. probably guilty of tax evasion
- D. in violation of the relevance assumption

49. Which one of the following assumptions or principles most logically supports the preparation of a single set of consolidated financial statements that combines the financial information of several wholly owned but separately identifiable businesses?

- A. historical cost
- B. industry practices
- C. reporting entity
- D. materiality

50. Expenses are recognized and matched against revenues on the basis of three principles. Which of the following is *not* one of these principles?

- A. immediate consumption
- B. associating cash flows
- C. systematic and rational allocation over time
- D. cause and effect

51. Which of the following sets includes only accounting assumptions and conventions?

- A. timeliness, prudence, historical cost, and neutrality
- B. matching, comparability, period of time, and faithful representation
- C. monetary unit, going concern, relevance, and materiality
- D. monetary unit, entity, going concern, and recognition

52. The use of the historical cost principle is justified because the resulting information has the qualitative characteristics of
- A. neutrality and materiality
  - B. neutrality and verifiability
  - C. timeliness and relevance
  - D. verifiability and predictive value
53. What additional supplementary information should be included as part of the financial statements under GAAP?
- A. Economic statistics
  - B. Notes to financial statements
  - C. Letters to Stockholder's
  - D. Management Discussion and Analysis
54. FASB's financial reporting model identifies which specific financial statements?
- A. Statement of Shareholder's Equity
  - B. Statements of Net Income and Comprehensive Income
  - C. Statement of Financial Position
  - D. All of these choices
55. What sources of information used by external decision making are directly affected by existing FASB standards?
- A. Accounting Policies
  - B. Management Discussion and Analysis
  - C. Economic Statistics
  - D. Letters to Stockholders
56. What three phases were active under the Joint FASB and IASB convergence project but were put on hold to focus on other convergence topics?
- A. Reporting entity, measurement, and presentation and disclosure
  - B. Framework for a GAAP hierarchy, elements and recognition , and objective and qualitative characteristics
  - C. Elements and recognition, measurement, presentation and disclosure
  - D. Measurement, reporting entity, and elements and recognition
57. How many phases of the FASB / IASB convergence project are there?
- A. 6
  - B. 8
  - C. 3
  - D. over 10

58. The IASB and FASB joint boards have identified the primary user groups of financial information as all of the following *except*

- A. equity investors
- B. labor groups
- C. lenders
- D. other creditors (capital providers)

59. The joint IASB and FASB boards identified several "enhancing" decision useful characteristics of financial information including

- A. comparability, verifiability, timeliness, and understandability
- B. materiality, verifiability, timeliness, and understandability
- C. comparability, verifiability, timeliness, and materiality
- D. comparability, relevance, timeliness, and understandability

60. Which of the following is a phase of the joint FASB and IASB conceptual framework project?

- A. going-concern assumption
- B. mixed attribute measurement
- C. elements and recognition
- D. period of time assumption

61. A list of statements follows:

- a. \_\_\_\_\_ are applications of \_\_\_\_\_ and \_\_\_\_\_ to differing types of transactions.
- b. \_\_\_\_\_ are specific implementation procedures.
- c. \_\_\_\_\_ and \_\_\_\_\_ are broad and definitional.
- d. The accounting projects for the conceptual framework project for financial accounting and reporting define the accounting \_\_\_\_\_, how they should be \_\_\_\_\_ and \_\_\_\_\_.

**Required:**

Fill in the words necessary to complete the statements.

62. The FASB's Conceptual Framework was established as a foundation for many interrelated objectives, concepts, principles and definitions. The following is a series of descriptive statements.

- a. SEC
- b. Conceptual Framework
- c. Concept Statement
- d. FASB

- \_\_\_\_\_ 1. Definition of basic accounting elements, for example what constitutes an asset or liability
- \_\_\_\_\_ 2. Is the guide in establishing accounting standards for FASB.
- \_\_\_\_\_ 3. The fundamental principles of accounting.
- \_\_\_\_\_ 4. The development of the conceptual framework for financial accounting was charged by which agency?
- \_\_\_\_\_ 5. Is expected to increase the user's confidence and understanding of financial reporting.
- \_\_\_\_\_ 6. Charged with establishing standards for the financial accounting practice.

**Required:**

Match each objective with the appropriate statement by placing the appropriate letter in the space provided.

63. A list of statements follows:

- a. GAAP identifies the \_\_\_\_\_ of financial reporting.
- b. Financial reporting should, above all, provide information that is \_\_\_\_\_ to external decision makers.
- c. A company's financial statements and other means of financial reporting should include explanations and interpretations by its management to help external users understand the financial information provided. This represents management's \_\_\_\_\_ to outsiders.
- d. Financial reporting should provide information about how \_\_\_\_\_ and \_\_\_\_\_ the company's management and governing board have discharged their responsibilities to use the company's resources.
- e. A specific objective of financial reporting is to provide information about how a company's cash flow can cause changes in the company's \_\_\_\_\_ and \_\_\_\_\_.

**Required:**

Fill in the words necessary to complete the statements.

64. A list of statements follows:

- a. \_\_\_\_\_ on \_\_\_\_\_ provides a measure of overall company performance.
- b. \_\_\_\_\_ is the uncertainty or unpredictability of the future results of a company.
- c. \_\_\_\_\_ is the ability of a company to take effective actions to change the amounts and timing of cash flows.
- d. \_\_\_\_\_ is the term used to describe how quickly a company can convert its assets into cash to pay a liability.
- e. \_\_\_\_\_ refers to the ability of a company to maintain a given physical level of operations.

**Required:**

Fill in the words necessary to complete the statements.

65. A list of statements follows:

- a. GAAP states that the two primary qualitative characteristics that make accounting information useful for decision-making purposes are \_\_\_\_\_ and \_\_\_\_\_.
- b. Corporations prepare quarterly financial statements in order to help achieve \_\_\_\_\_, an ingredient of the primary quality of relevance.
- c. Expensing the purchase of waste paper baskets that have a three-year estimated useful life at the date of acquisition is a permissible procedure according to the \_\_\_\_\_ constraint.
- d. The three components of relevance are \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.
- e. \_\_\_\_\_ is the overall qualitative characteristic to be used in judging the quality of accounting information.

**Required:**

Fill in the words necessary to complete the statements.

66. Below is a list of the qualitative characteristics identified by GAAP. Following the list is a series of descriptive phrases.

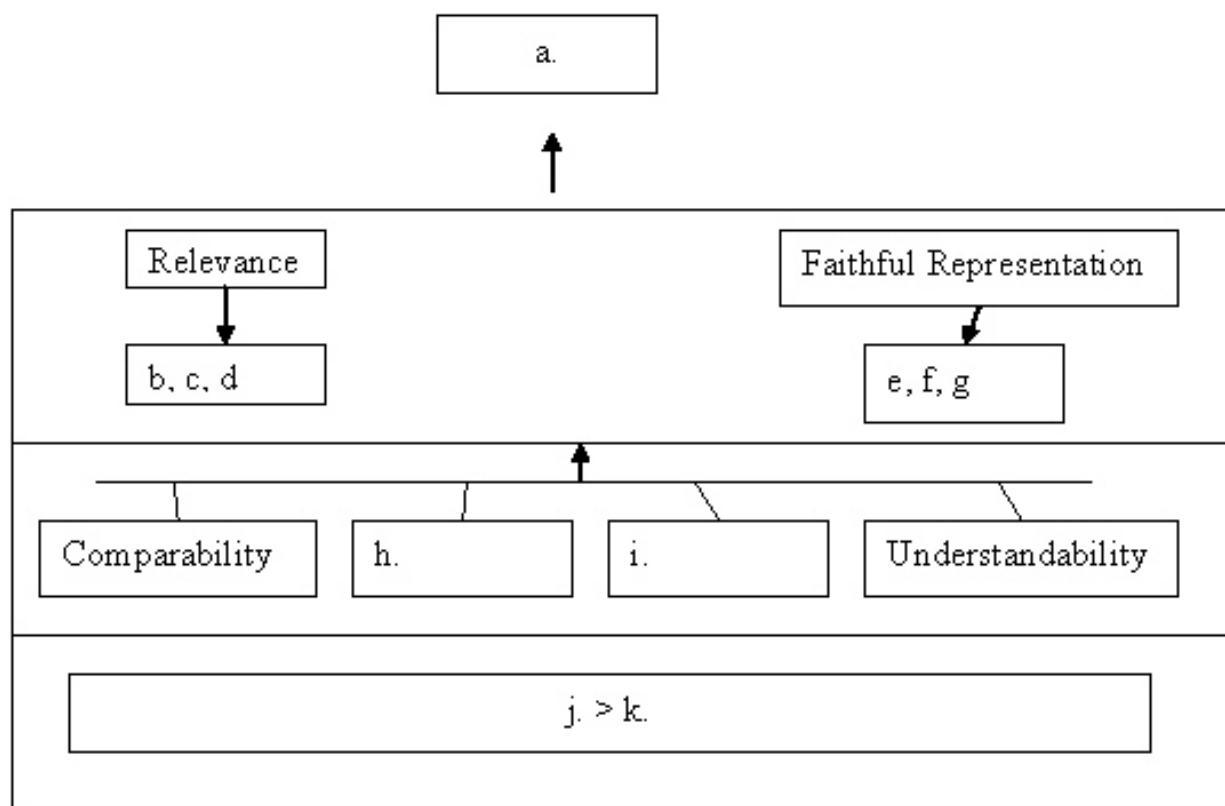
- |    |                     |    |                               |
|----|---------------------|----|-------------------------------|
| a. | feedback value      | g. | verifiability                 |
| b. | relevance           | h. | consistency                   |
| c. | decision usefulness | i. | representational faithfulness |
| d. | reliability         | j. | timeliness                    |
| e. | comparability       | k. | neutrality                    |
| f. | predictive value    |    |                               |

- |       |     |   |
|-------|-----|---|
| _____ | 1.  | When information can make a difference in a decision.                         |
| _____ | 2.  | Making information available when it is needed.                               |
| _____ | 3.  | When accounting policies and procedures are unchanged from period to period.  |
| _____ | 4.  | When information is verifiable and neutral.                                   |
| _____ | 5.  | Occurs when the measurement results can be duplicated.                        |
| _____ | 6.  | The overall qualitative characteristic accounting information should possess. |
| _____ | 7.  | When information enables decision makers to confirm prior expectations.       |
| _____ | 8.  | When accounting information is reported the same way by different companies.  |
| _____ | 9.  | Accounting information should help users form expectations about the future.  |
| _____ | 10. | Does not give the appearance of biased information.                           |
| _____ | 11. | The information must be complete and free from errors.                        |

**Required:**

Match each characteristic with the appropriate phrase.

67. The tentative FASB and IASB Joint Conceptual Framework is presented below.



**Required:**

Provide the qualitative characteristic for each lettered box.

- a. \_\_\_\_\_
- b. \_\_\_\_\_
- c. \_\_\_\_\_
- d. \_\_\_\_\_
- e. \_\_\_\_\_
- f. \_\_\_\_\_
- g. \_\_\_\_\_
- h. \_\_\_\_\_
- i. \_\_\_\_\_
- j. \_\_\_\_\_
- k. \_\_\_\_\_

68. Following the list below is a series of descriptions of inappropriate accounting procedures.

- a. full disclosure
- b. historical cost
- c. revenue recognition
- d. conservatism
- e. monetary-unit assumption
- f. matching principle
- g. period of time

- \_\_\_\_\_ 1. The company signs a contract to produce four machines according to the customer's specifications. On the date of the contract, the customer pays one half of the total contract price, and the company records the cash receipt as a sale. The machines will be manufactured and delivered during the next year.
- \_\_\_\_\_ 2. The company delayed issuing its annual financial statements in order to include a large sale expected early in the next year.
- \_\_\_\_\_ 3. The market value of the company's inventory declined sharply. The president, optimistically predicting a rise in value, insisted that the inventory be reported at its historical cost.
- \_\_\_\_\_ 4. The market value of the company's large inventory rose sharply. The inventory was reported on the balance sheet at current market value.
- \_\_\_\_\_ 5. Although the company can estimate its uncollectible accounts receivable, it does not recognize the bad debts expense until it determines that an account receivable is uncollectible.

**Required:**

Indicate which item (or items) on the list was (were) violated in each description by placing the appropriate letter(s) in the space provided.



69. Below is a list of accounting assumptions, conventions, and principles. Following the list is a series of descriptive statements.

- a. entity assumption
- b. historical cost principle
- c. going-concern assumption
- d. conservatism convention
- e. monetary-unit assumption
- f. matching principle
- g. period of time
- h. realization
- i. recognition

- \_\_\_ 1. A company records sales on account when providing a service.
- \_\_\_ 2. A company recognizes as expense the portion of its prepaid rent that has expired.
- \_\_\_ 3. A company reports the land that it purchased in 1990 for \$500,000, at the same amount on its 2013 balance sheet.
- \_\_\_ 4. A company reports its inventories on the balance sheet at the lower of cost or market.
- \_\_\_ 5. An entity is preparing its five-year strategic plan.
- \_\_\_ 6. A company amortizes its patent, an intangible asset, over its useful life.
- \_\_\_ 7. All financial statements are prepared without the assumption of inflation.
- \_\_\_ 8. The financial statements of the company are prepared separate from the owners.
- \_\_\_ 9. Revenue is recognized at the time the product is sold, shipped, or delivered.

**Required:**

Match each item in the list with its descriptive statement by placing the appropriate letter(s) in the space provided.

70. Presented below are five inappropriate accounting procedures that are being used by the Playground Equipment Corporation.

- a. On the year-end balance sheet, Playground Equipment Corporation reported its inventory at market value, which was greater than cost. As a result of this procedure, a gain was recognized on the company's income statement.
- b. Mrs. Devlin, the president of the company, purchased an automobile for her son using the company's money. The company's accountant recorded the expenditure as salaries expense.
- c. Playground Equipment Corporation reported income from operations of \$5,000,000 for the current year. During the year, Devlin settled and paid a \$5,000,000 class action lawsuit against the company resulting from damages incurred from the sale of defective products. The settlement was reported as a miscellaneous expense with no footnotes provided.
- d. Playground Equipment is going to issue additional common stock next year. In order to improve its income, the company switched from the LIFO inventory cost flow method to FIFO. The company did not disclose the accounting change. Comparative financial statements were prepared.
- e. The company made \$3,000,000 of expenditures to expand a building that originally cost \$5,000,000. The expenditures are expected to benefit operations over the building's remaining useful life of ten years. The expenditures were expensed as maintenance.

**Required:**

For each of the above items, list the accounting assumption(s), convention(s), or principle(s) that is (are) being violated.

71. Below are the sources of information used in external decision making.

- a. Financial Statements
- b. Notes to Financial Statements
- c. Supplementary Information
- d. Other means of financial reporting
- e. Other Information

- |       |     |                                       |
|-------|-----|---------------------------------------|
| _____ | 1.  | Changing prices disclosures           |
| _____ | 2.  | Letters to stockholders               |
| _____ | 3.  | Statement of Shareholders' Equity     |
| _____ | 4.  | Accounting policies                   |
| _____ | 5.  | Management discussion and analysis    |
| _____ | 6.  | News article about the company        |
| _____ | 7.  | Statement of Financial Position       |
| _____ | 8.  | Inventory Methods                     |
| _____ | 9.  | Number of shares of stock outstanding |
| _____ | 10. | Analyst reports                       |

**Required:**

Match each element with the appropriate statement by placing the appropriate letter in the space provided.

72. List the eight phases of the Joint FASB and IASB Conceptual Framework Project.

- 1 \_\_\_\_\_
- 2 \_\_\_\_\_
- 3 \_\_\_\_\_
- 4 \_\_\_\_\_
- 5 \_\_\_\_\_
- 6 \_\_\_\_\_
- 7 \_\_\_\_\_
- 8 \_\_\_\_\_

73. The boards are planning to evaluate various measurement techniques for assets and liabilities in order to satisfy objective and qualitative characteristics. To date nine measurement techniques have been identified.

**Required:**

List those techniques below.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_
6. \_\_\_\_\_
7. \_\_\_\_\_
8. \_\_\_\_\_
9. \_\_\_\_\_

74. The FASB and IASB have joined forces to develop a joint Conceptual Framework. The joint task force's objective is to provide a sound foundation for both boards to develop accounting standards. This framework is essential to fulfilling the board's goal. What is the goal?

75. FASB's Statements of Financial Accounting Concepts that are general proclamations. List two proclamations that form the basis of GAAP.

76. What types of information would be helpful in accessing the amounts, timing, and uncertainty of future cash flows?

77. How is the information concerning the company's net income, comprehensive income and their components useful to external users?

78. Define the following terms as they relate to decision usefulness, the ultimate objective of accounting information.

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

79. The FASB and IASB describe four characteristics that enhance the decision usefulness of information that is relevant and faithfully represented. What are these characteristics and provide a brief explanation of each.

80. List 5 of the important accounting assumptions that have had an impact on the development of GAAP and Accounting.

81. The Framework of Financial Accounting Theory and Practice is made up based upon several objectives. Provide a brief summary of one of these objectives.

82. Financial statements elements arranged in basic financial statements provide limited information for external users to ascertain the necessary information in which to base decisions upon. What are some other ways companies can disclose financial information to external users?

83. List the three phases of the FASB and IASB convergence project that have been placed on hold in order in order that the two boards focus on finalizing convergence on several other topics.

84. At lunch recently, two accountants were discussing the merits of the FASB's conceptual framework project, which resulted in the publication of seven *Statements of Financial Accounting Concepts* and required more than ten years of effort. One accountant thought the effort was a waste of resources, since accounting was unlike physics, chemistry, and biology, where natural laws apply. The other accountant thought the effort was very valuable. He stated that "accounting, like any other discipline, benefits from having a coherent theory."

**Required:**

Write a brief essay that discusses the advantages that are derived from the existence of a conceptual framework for financial accounting and reporting.

85. The task of developing the conceptual framework was so enormous that the FASB had to divide it into several projects.

**Required:**

Identify each of the projects by name and provide a brief description of their results.

86. GAAP lists and describes the qualitative characteristics that make accounting information useful for decision-making purposes. The FASB viewed the characteristics as a hierarchy of qualities that make accounting information useful. The FASB stated that accounting information must possess both relevance and faithful representation qualities to be useful, but it was noted that relevance and faithful representation may conflict with each other in some instances. For example, to increase relevance, faithful representation may have to be sacrificed, or vice versa.

**Required:**

- a. Define "relevance" and "faithful representation" and list the components or "ingredients" of each quality.
- b. Give an example in financial accounting that illustrates the following tradeoffs:
  - (1) Relevance is sacrificed in order to make accounting information more reliable.
  - (2) Faithful representation is sacrificed in order to make accounting information more relevant.



87. The IASB/FASB tentative joint conceptual framework includes two "fundamental qualitative characteristics" that must be present for financial reporting information to be useful.

**Required:**

Name and describe the two joint conceptual framework fundamental characteristics.

88. Discuss the financial reporting model in the FASB Conceptual Framework.

## Chapter 2--Financial Reporting: Its Conceptual Framework **Key**

1. Accounting principles are theories, truths, and propositions that service as the basis for financial accounting and reporting.

**TRUE**

2. The rules for accounting are based upon concepts, and principles which broad and subject to an interpretation.

**FALSE**

3. Information is communicated to external users by the management of the company. Those users cannot dictate desired financial results to the company.

**TRUE**

4. The primary purpose of financial reporting is to provide useful and relevant information to the internal stakeholder's of the company.

**FALSE**

5. Management's stewardship is to provide information about how a company's cash flows cause changes in the company's resources and claim's.

**FALSE**

6. Liquidity is positively related to financial flexibility but negatively related to risk and return on investments.

**TRUE**

7. Relevance and faithful representation are the ultimate objectives of accounting information.

**FALSE**

8. To measure assets, liabilities, revenues, expenses, and other elements of the financial statements with the most relevant and faithful measurement available is the mixed attribute measurement model.

**TRUE**

9. Oil and gas reserves information would be included within the financial statements.

**FALSE**

10. Management discussion and analysis would be included in the supplementary information to the financial statements.

**FALSE**

11. The eight phases of the joint FASB and IASB framework project are: 1) objective and qualitative characteristics, 2) elements and recognition, 3) presentation and disclosure, 4) reporting entity, 5) measurement, 6) framework for GAAP hierarchy, 7) applicability to the not-for-profit sector, and 8) any remaining issues needing to be addressed.

**TRUE**

12. Three phases of the convergence project were put on hold they were elements and recognition, measurement, and presentation and disclosure.

**FALSE**

13. Which of the following statements is *not* true with regard to the benefits derived from the FASB's conceptual framework of accounting?

A. It serves as a guide in establishing standards for the FASB.

**B.** The *Statements of Financial Accounting Concepts* is the primary source of GAAP for accountants.

C. It establishes the objectives of financial reporting.

D. It enhances comparability between different company's financial statements.

14. Which of the following items is NOT included in FASB's conceptual framework of accounting theory?

A. qualities of useful accounting information

B. fundamental principles and assumptions that guide financial accounting and reporting

C. objectives of financial reporting

**D.** All of these choices are included in the conceptual framework

15. The first part of the conceptual framework project had to do with establishing which projects?

- A. elements
- B. objectives**
- C. qualitative characteristics
- D. recognition and measurement

16. The accounting projects portion of the FASB's conceptual framework project deals with

- A. which accounting elements should be reported and how they should be measured**
- B. which accounting elements should be reported and where the information should be reported
- C. how the accounting elements should be measured and how information should be displayed in financial reports
- D. when accounting elements should be recognized and how information should be displayed in financial reports

17. The accounting projects portion of the FASB's conceptual framework project deals with all of the following *except*

- A. how elements should be measured
- B. when various elements should be reported
- C. which accounting elements should be reported
- D. how financial reports should be displayed**

18. What is the goal of FASB and IASB in the creation of the conceptual framework?

- A. To develop standards that are internally consistent.
- B. To develop standards that are internationally converged.
- C. To develop standards that lead to financial reporting that provides clear consistent information to capital providers.
- D. All of these choices**

19. The FASB and IASB concluded that the most general objective of financial reporting is to

- A. provide information useful in the decisions made by external users**
- B. meet the needs of internal users
- C. provide information about an entity's earnings
- D. provide information about an entity's cash flows

20. According to GAAP, which is *not* a specific objective?

- A. to provide information about an enterprise's cash flows
- B.** to provide information that is useful to present to potential investors, creditors, and other users in making rational investment, credit, and similar decisions
- C. to provide information about an enterprise's comprehensive income and its components
- D. to provide information about an enterprise's economic resources, obligations, and owners' equity

21. Information about comprehensive income is useful to external users for all of the following purposes *except*

- A. evaluating management's performance
- B.** examining cash flows for the current period
- C. predicting future income
- D. assessing the risk of lending to the company

22. In its "Objectives of Financial Reporting by Business Enterprises" the FASB identified a variety of primary users including all of the following *except*

- A.** internal management
- B. investors
- C. creditors
- D. security analysts

23. Which of the following is a specific objective of financial reporting?

- A. provide information that is useful to investors in making investment decisions
- B. provide information useful in assessing the amounts, timing, and uncertainty of prospective cash receipts
- C. provide information useful in assessing the amounts, timing, and uncertainty of prospective cash inflows
- D.** provide information about a company's resources and the claims against the company

24. Accrual accounting relates the financial effects of a company's transactions

- A. so that the costs of nonoperational events are matched to the balance sheet in the period impacted
- B.** to the period in which they occur rather than to when the cash receipts or payment occurs
- C. so that the revenue impact of every transaction in a period is properly reflected in the income statement
- D. so that the impact of every transaction is reflected in the statement of cash flows

25. Which of the following statements regarding financial flexibility is true?

- A. It is the ability of a company to provide a return on investment.
- B. It is the ability of a company to take effective actions to insure the return of capital to the company.
- C.** It is the ability of a company to take adapt changes in the amounts and timing of cash flows.
- D. It is the ability of a company to maintain a given level of operations.

26. Which of the following types of information was specifically identified by the FASB as being useful in assessing the amounts, timing, and uncertainty of a company's future cash flows?

- A.** liquidity
- B. return of investment
- C. financial capability
- D. credit standing

27. When investors and creditors make investment and credit decisions, they need information to assist them in assessing future cash receipts. Their focus is on assessing the potential of generating

- A. a return *of* investment of capital
- B. a return *on* investment of capital
- C.** both a return *of* and a return *on* investment of capital
- D. neither a return *of* nor a return *on* investment of capital

28. Which qualitative characteristic is an ingredient of relevance?

- A. understandability
- B.** materiality
- C. neutrality
- D. representational faithfulness

29. According to the FASB hierarchy of fundamental qualitative characteristics, the two primary qualities making accounting information useful are

- A. understandability and decision usefulness
- B.** relevance and faithful representation
- C. verifiability and neutrality
- D. predictive value and feedback value

30. Which fundamental characteristic is an ingredient of faithful representation?

- A. predictive value
- B. confirmatory value
- C. timeliness
- D.** neutrality

31. In order to be relevant, accounting information should have

- A. timeliness
- B. verifiability
- C.** confirmatory value
- D. All of these choices

32. Which of the following fundamental qualitative characteristics may have to be sacrificed in order to achieve timeliness?
- A. relevance
  - B.** verifiability
  - C. comparability
  - D. predictive value
33. What is the ultimate objective of accounting information?
- A. faithful representation
  - B.** decision usefulness
  - C. relevance
  - D. predictive value
34. Which of the following are considered enhancing characteristics of accounting information?
- A. verifiability and confirmatory value
  - B. predictive value and timeliness
  - C.** comparability and consistency
  - D. representational faithfulness and neutrality
35. A constraint mentioned by GAAP on qualitative characteristics is
- A. understandability
  - B. timeliness
  - C. faithful representation
  - D.** benefits greater than costs
36. Which of the following items would most likely be a violation of the materiality constraint?
- A. A company did not separately report an unusual gain of \$100,000. Its income from operations was \$20,000,000.
  - B. A company having reported total assets of \$50,000,000 immediately expensed the purchase of 20 pencil sharpeners that have an estimated useful life of three years.
  - C.** A \$75,000 illegal bribe by an executive of the company to a foreign official was not separately disclosed in the annual report.
  - D. A \$2,000 expenditure to improve a building that originally cost \$10,000,000 was immediately expensed.

37. The IASB and FASB boards have agreed that the objective of general purpose financial reporting is to provide

- A.** financial information about a company that is useful to investors, lenders and other creditors
- B. mainly cash flow information about a company that is useful to external users in making decisions in their capacity as capital providers
- C. financial information about a company that is useful to internal users in making decisions in their capacity as capital custodians
- D. financial information about a company that is used by government regulators for taxation

38. Similar to the constraints in the FASB's qualitative characteristics, the joint IASB/FASB boards have identified which constraint

- A. consistency
- B.** benefits that justify the costs
- C. materiality
- D. objectivity

39. Long Corporation has adopted the policy of charging to expense at the time of purchase all assets having a cost of less than \$200, regardless of the life expectancy of the asset. This policy is most closely related to the

- A. historical cost principle
- B. period-of-time assumption
- C. verifiability principle
- D.** materiality principle

40. Intracompany comparability would be violated if

- A. a company used LIFO as its inventory cost method while other companies in the same industry used FIFO
- B.** a company changed its bad debts expense estimate from one percent to two percent
- C. a bank did not classify its assets as current assets and noncurrent assets
- D. a company expenses all expenditures of less than \$500 even if the expenditures result in probable future economic benefit

41. Understandability is a characteristic that is

- A. a secondary and interactive quality
- B. a threshold for recognition
- C. an overall quality
- D.** an enhancing quality



42. The materiality of an item of financial information refers to the likelihood that its omission or misstatement would affect the decisions of those relying on that information and thus make differing choices if the information had been presented. This concept most closely relates to the

- A.** financial magnitude of the item
- B. verifiability of the item
- C. neutrality of the item
- D. confirmatory value of the item

43. All of the following items are classified as accounting assumptions and conventions *except* for

- A. going concern
- B.** timeliness
- C. monetary unit
- D. reporting entity

44. The city of Anchorage sold land for its appraised value to the Big Bear Oil Company on June 1, 2014, that originally cost the city \$950,000. On June 1, 2014, the land was appraised at a value of \$1,400,000, and on December 31, 2014, the land's value was estimated to be \$1,450,000. On Big Bear Oil Company's balance sheet at December 31, 2014, the land should be valued at

- A.** \$1,400,000
- B. \$1,450,000
- C. \$950,000
- D. \$ 0

45. Using the straight-line method to amortize patents is an application of expense recognition using

- A. cause and effect
- B.** a systematic and rational allocation over time
- C. immediate consumption
- D. the percentage-of-completion method

46. Using an allowance method of accounting to recognize uncollectible accounts receivable is an application of which accounting convention?

- A. revenue recognition
- B. historical cost
- C.** matching principle
- D. period of time

47. The state legislature is currently debating a bill that, if passed, would require the Roberts Company to go out of business. Which of the following principles or assumptions related to the preparation of Roberts financial statements is most directly affected by this impending vote of the legislature?

- A.** going concern
- B. verifiability principle
- C. entity concept
- D. materiality concept

48. A company that uses accounting methods in preparing its tax returns that differ from the accounting methods used to prepare its financial statements is

- A. in violation of the consistency principle
- B.** not necessarily violating either the income tax laws or generally accepted accounting principles
- C. probably guilty of tax evasion
- D. in violation of the relevance assumption

49. Which one of the following assumptions or principles most logically supports the preparation of a single set of consolidated financial statements that combines the financial information of several wholly owned but separately identifiable businesses?

- A. historical cost
- B. industry practices
- C.** reporting entity
- D. materiality

50. Expenses are recognized and matched against revenues on the basis of three principles. Which of the following is *not* one of these principles?

- A. immediate consumption
- B.** associating cash flows
- C. systematic and rational allocation over time
- D. cause and effect

51. Which of the following sets includes only accounting assumptions and conventions?

- A. timeliness, prudence, historical cost, and neutrality
- B. matching, comparability, period of time, and faithful representation
- C. monetary unit, going concern, relevance, and materiality
- D.** monetary unit, entity, going concern, and recognition

52. The use of the historical cost principle is justified because the resulting information has the qualitative characteristics of

- A. neutrality and materiality
- B.** neutrality and verifiability
- C. timeliness and relevance
- D. verifiability and predictive value

53. What additional supplementary information should be included as part of the financial statements under GAAP?

- A. Economic statistics
- B.** Notes to financial statements
- C. Letters to Stockholder's
- D. Management Discussion and Analysis

54. FASB's financial reporting model identifies which specific financial statements?

- A. Statement of Shareholder's Equity
- B. Statements of Net Income and Comprehensive Income
- C. Statement of Financial Position
- D.** All of these choices

55. What sources of information used by external decision making are directly affected by existing FASB standards?

- A.** Accounting Policies
- B. Management Discussion and Analysis
- C. Economic Statistics
- D. Letters to Stockholders

56. What three phases were active under the Joint FASB and IASB convergence project but were put on hold to focus on other convergence topics?

- A. Reporting entity, measurement, and presentation and disclosure
- B. Framework for a GAAP hierarchy, elements and recognition, and objective and qualitative characteristics
- C. Elements and recognition, measurement, presentation and disclosure
- D.** Measurement, reporting entity, and elements and recognition

57. How many phases of the FASB / IASB convergence project are there?

- A. 6
- B.** 8
- C. 3
- D. over 10

58. The IASB and FASB joint boards have identified the primary user groups of financial information as all of the following *except*

- A. equity investors
- B.** labor groups
- C. lenders
- D. other creditors (capital providers)

59. The joint IASB and FASB boards identified several "enhancing" decision useful characteristics of financial information including

- A.** comparability, verifiability, timeliness, and understandability
- B. materiality, verifiability, timeliness, and understandability
- C. comparability, verifiability, timeliness, and materiality
- D. comparability, relevance, timeliness, and understandability

60. Which of the following is a phase of the joint FASB and IASB conceptual framework project?

- A. going-concern assumption
- B. mixed attribute measurement
- C.** elements and recognition
- D. period of time assumption

61. A list of statements follows:

- a. \_\_\_\_\_ are applications of \_\_\_\_\_ and \_\_\_\_\_ to differing types of transactions.
- b. \_\_\_\_\_ are specific implementation procedures.
- c. \_\_\_\_\_ and \_\_\_\_\_ are broad and definitional.
- d. The accounting projects for the conceptual framework project for financial accounting and reporting define the accounting \_\_\_\_\_, how they should be \_\_\_\_\_ and \_\_\_\_\_.

**Required:**

Fill in the words necessary to complete the statements.

- a. Standards,  
concepts,  
principles
- b. Rules
- c. Concept  
statements,  
principles
- d. elements,  
recognized,  
measured

62. The FASB's Conceptual Framework was established as a foundation for many interrelated objectives, concepts, principles and definitions. The following is a series of descriptive statements.

- a. SEC
- b. Conceptual Framework
- c. Concept Statement
- d. FASB

- \_\_\_\_\_ 1. Definition of basic accounting elements, for example what constitutes an asset or liability
- \_\_\_\_\_ 2. Is the guide in establishing accounting standards for FASB.
- \_\_\_\_\_ 3. The fundamental principles of accounting.
- \_\_\_\_\_ 4. The development of the conceptual framework for financial accounting was charged by which agency?
- \_\_\_\_\_ 5. Is expected to increase the user's confidence and understanding of financial reporting.
- \_\_\_\_\_ 6. Charged with establishing standards for the financial accounting practice.

**Required:**

Match each objective with the appropriate statement by placing the appropriate letter in the space provided.

- 1. c
- 2. b
- 3. c
- 4. a
- 5. b
- 6. d

63. A list of statements follows:

- a. GAAP identifies the \_\_\_\_\_ of financial reporting.
- b. Financial reporting should, above all, provide information that is \_\_\_\_\_ to external decision makers.
- c. A company's financial statements and other means of financial reporting should include explanations and interpretations by its management to help external users understand the financial information provided. This represents management's \_\_\_\_\_ to outsiders.
- d. Financial reporting should provide information about how \_\_\_\_\_ and \_\_\_\_\_ the company's management and governing board have discharged their responsibilities to use the company's resources.
- e. A specific objective of financial reporting is to provide information about how a company's cash flow can cause changes in the company's \_\_\_\_\_ and \_\_\_\_\_.

**Required:**

Fill in the words necessary to complete the statements.

- a. objectives
- b. useful
- c. full disclosure
- d. efficiently, effectively
- e. resources, claims

64. A list of statements follows:

- a. \_\_\_\_\_ on \_\_\_\_\_ provides a measure of overall company performance.
- b. \_\_\_\_\_ is the uncertainty or unpredictability of the future results of a company.
- c. \_\_\_\_\_ is the ability of a company to take effective actions to change the amounts and timing of cash flows.
- d. \_\_\_\_\_ is the term used to describe how quickly a company can convert its assets into cash to pay a liability.
- e. \_\_\_\_\_ refers to the ability of a company to maintain a given physical level of operations.

**Required:**

Fill in the words necessary to complete the statements.

- a. Return, investment
- b. Risk
- c. Financial flexibility
- d. Liquidity
- e. Operating capability

65. A list of statements follows:

- a. GAAP states that the two primary qualitative characteristics that make accounting information useful for decision-making purposes are \_\_\_\_\_ and \_\_\_\_\_.
- b. Corporations prepare quarterly financial statements in order to help achieve \_\_\_\_\_, an ingredient of the primary quality of relevance.
- c. Expensing the purchase of waste paper baskets that have a three-year estimated useful life at the date of acquisition is a permissible procedure according to the \_\_\_\_\_ constraint.
- d. The three components of relevance are \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.
- e. \_\_\_\_\_ is the overall qualitative characteristic to be used in judging the quality of accounting information.

**Required:**

Fill in the words necessary to complete the statements.

- a. relevance, faithful representation
- b. timeliness
- c. materiality
- d. predictive value, confirmatory value, materiality
- e. Decision usefulness

66. Below is a list of the qualitative characteristics identified by GAAP. Following the list is a series of descriptive phrases.

- |                        |                                  |
|------------------------|----------------------------------|
| a. feedback value      | g. verifiability                 |
| b. relevance           | h. consistency                   |
| c. decision usefulness | i. representational faithfulness |
| d. reliability         | j. timeliness                    |
| e. comparability       | k. neutrality                    |
| f. predictive value    |                                  |

- |       |     |   |
|-------|-----|---|
| _____ | 1.  | When information can make a difference in a decision.                         |
| _____ | 2.  | Making information available when it is needed.                               |
| _____ | 3.  | When accounting policies and procedures are unchanged from period to period.  |
| _____ | 4.  | When information is verifiable and neutral.                                   |
| _____ | 5.  | Occurs when the measurement results can be duplicated.                        |
| _____ | 6.  | The overall qualitative characteristic accounting information should possess. |
| _____ | 7.  | When information enables decision makers to confirm prior expectations.       |
| _____ | 8.  | When accounting information is reported the same way by different companies.  |
| _____ | 9.  | Accounting information should help users form expectations about the future.  |
| _____ | 10. | Does not give the appearance of biased information.                           |
| _____ | 11. | The information must be complete and free from errors.                        |

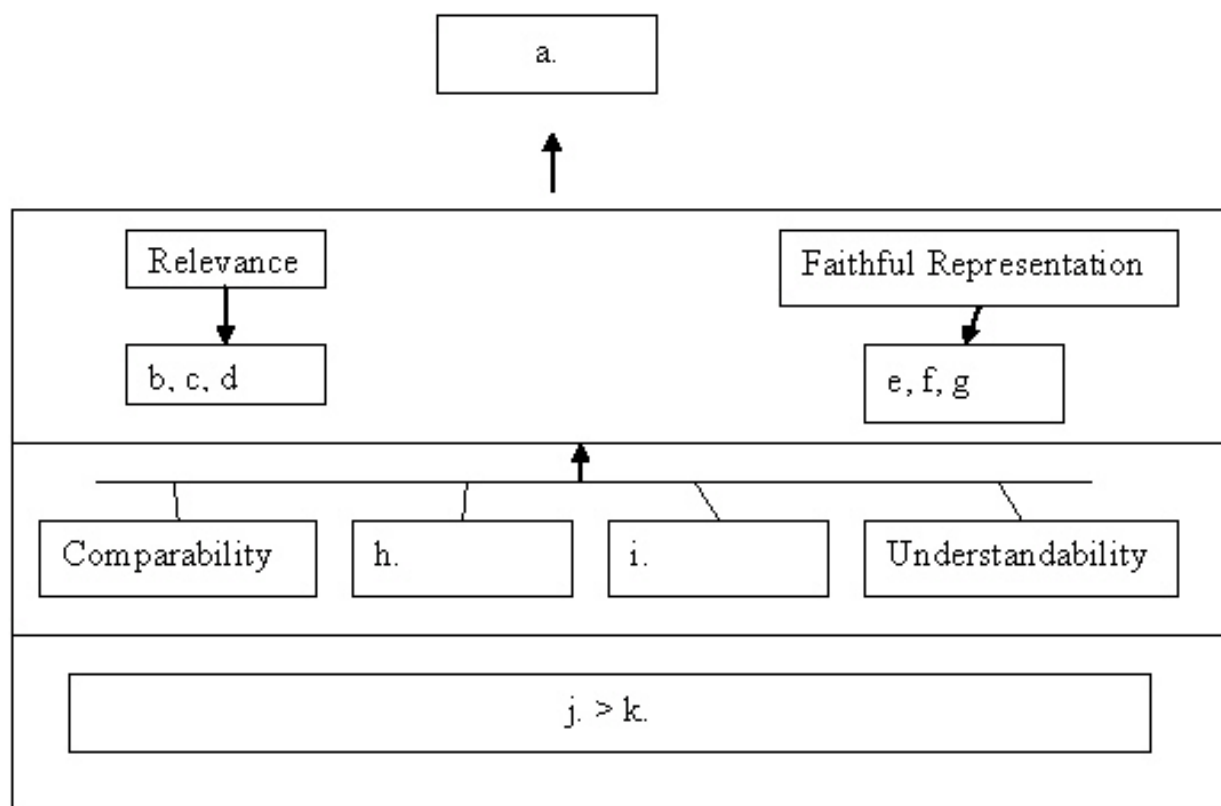
**Required:**

Match each characteristic with the appropriate phrase.

- |    |   |     |
|----|---|-----|
| 1. | b | 7.a |
| 2. | j | 8.e |
| 3. | h | 9.f |
| 4. | d | 1 k |
|    |   | 0.  |
| 5. | g | 1 i |
|    |   | 1.  |
| 6. | c |     |



67. The tentative FASB and IASB Joint Conceptual Framework is presented below.



**Required:**

Provide the qualitative characteristic for each lettered box.

- a. \_\_\_\_\_
- b. \_\_\_\_\_
- c. \_\_\_\_\_
- d. \_\_\_\_\_
- e. \_\_\_\_\_
- f. \_\_\_\_\_
- g. \_\_\_\_\_
- h. \_\_\_\_\_
- i. \_\_\_\_\_
- j. \_\_\_\_\_
- k. \_\_\_\_\_

- a. decision usefulness
- b. predictive value
- c. confirmatory value
- d. materiality
- e. completeness
- f. neutrality
- g. free from error
- h. verifiability
- i. timeliness
- j. benefits
- k. costs

68. Following the list below is a series of descriptions of inappropriate accounting procedures.

- a. full disclosure
- b. historical cost
- c. revenue recognition
- d. conservatism
- e. monetary-unit assumption
- f. matching principle
- g. period of time

- \_\_\_\_\_ 1. The company signs a contract to produce four machines according to the customer's specifications. On the date of the contract, the customer pays one half of the total contract price, and the company records the cash receipt as a sale. The machines will be manufactured and delivered during the next year.
- \_\_\_\_\_ 2. The company delayed issuing its annual financial statements in order to include a large sale expected early in the next year.
- \_\_\_\_\_ 3. The market value of the company's inventory declined sharply. The president, optimistically predicting a rise in value, insisted that the inventory be reported at its historical cost.
- \_\_\_\_\_ 4. The market value of the company's large inventory rose sharply. The inventory was reported on the balance sheet at current market value.
- \_\_\_\_\_ 5. Although the company can estimate its uncollectible accounts receivable, it does not recognize the bad debts expense until it determines that an account receivable is uncollectible.

**Required:**

Indicate which item (or items) on the list was (were) violated in each description by placing the appropriate letter(s) in the space provided.

- 1. c
- 2. f, c
- 3. d
- 4. b, c, d
- 5. g, d, f

69. Below is a list of accounting assumptions, conventions, and principles. Following the list is a series of descriptive statements.

- a. entity assumption
- b. historical cost principle
- c. going-concern assumption
- d. conservatism convention
- e. monetary-unit assumption
- f. matching principle
- g. period of time
- h. realization
- i. recognition

- \_\_\_ 1. A company records sales on account when providing a service.
- \_\_\_ 2. A company recognizes as expense the portion of its prepaid rent that has expired.
- \_\_\_ 3. A company reports the land that it purchased in 1990 for \$500,000, at the same amount on its 2013 balance sheet.
- \_\_\_ 4. A company reports its inventories on the balance sheet at the lower of cost or market.
- \_\_\_ 5. An entity is preparing its five-year strategic plan.
- \_\_\_ 6. A company amortizes its patent, an intangible asset, over its useful life.
- \_\_\_ 7. All financial statements are prepared without the assumption of inflation.
- \_\_\_ 8. The financial statements of the company are prepared separate from the owners.
- \_\_\_ 9. Revenue is recognized at the time the product is sold, shipped, or delivered.

**Required:**

Match each item in the list with its descriptive statement by placing the appropriate letter(s) in the space provided.

- 1. i
- 2. g, f
- 3. b
- 4. d
- 5. c
- 6. f
- 7. e
- 8. a
- 9. h

70. Presented below are five inappropriate accounting procedures that are being used by the Playground Equipment Corporation.

- a. On the year-end balance sheet, Playground Equipment Corporation reported its inventory at market value, which was greater than cost. As a result of this procedure, a gain was recognized on the company's income statement.
- b. Mrs. Devlin, the president of the company, purchased an automobile for her son using the company's money. The company's accountant recorded the expenditure as salaries expense.
- c. Playground Equipment Corporation reported income from operations of \$5,000,000 for the current year. During the year, Devlin settled and paid a \$5,000,000 class action lawsuit against the company resulting from damages incurred from the sale of defective products. The settlement was reported as a miscellaneous expense with no footnotes provided.
- d. Playground Equipment is going to issue additional common stock next year. In order to improve its income, the company switched from the LIFO inventory cost flow method to FIFO. The company did not disclose the accounting change. Comparative financial statements were prepared.
- e. The company made \$3,000,000 of expenditures to expand a building that originally cost \$5,000,000. The expenditures are expected to benefit operations over the building's remaining useful life of ten years. The expenditures were expensed as maintenance.

**Required:**

For each of the above items, list the accounting assumption(s), convention(s), or principle(s) that is (are) being violated.

- a. conservatism, historical cost, revenue recognition
- b. entity
- c. materiality, disclosure
- d. consistency, disclosure
- e. matching

71. Below are the sources of information used in external decision making.

- a. Financial Statements
- b. Notes to Financial Statements
- c. Supplementary Information
- d. Other means of financial reporting
- e. Other Information

- |       |     |                                       |
|-------|-----|---------------------------------------|
| _____ | 1.  | Changing prices disclosures           |
| _____ | 2.  | Letters to stockholders               |
| _____ | 3.  | Statement of Shareholders' Equity     |
| _____ | 4.  | Accounting policies                   |
| _____ | 5.  | Management discussion and analysis    |
| _____ | 6.  | News article about the company        |
| _____ | 7.  | Statement of Financial Position       |
| _____ | 8.  | Inventory Methods                     |
| _____ | 9.  | Number of shares of stock outstanding |
| _____ | 10. | Analyst reports                       |

**Required:**

Match each element with the appropriate statement by placing the appropriate letter in the space provided.

- |    |   |
|----|---|
| 1  | c |
| 2  | d |
| 3  | a |
| 4  | b |
| 5  | d |
| 6  | e |
| 7  | a |
| 8  | b |
| 9  | b |
| 10 | e |

72. List the eight phases of the Joint FASB and IASB Conceptual Framework Project.

- |   |       |
|---|-------|
| 1 | _____ |
| 2 | _____ |
| 3 | _____ |
| 4 | _____ |
| 5 | _____ |
| 6 | _____ |
| 7 | _____ |
| 8 | _____ |

- |    |  |
|----|--|
| 1. | objective and qualitative characteristics  |
| 2. | elements and recognition                   |
| 3. | measurement                                |
| 4. | reporting entity                           |
| 5. | presentation and disclosure                |
| 6. | framework for a GAAP hierarchy             |
| 7. | applicability to the not for profit sector |
| 8. | remaining issues                           |

73. The boards are planning to evaluate various measurement techniques for assets and liabilities in order to satisfy objective and qualitative characteristics. To date nine measurement techniques have been identified.

**Required:**

List those techniques below.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_
6. \_\_\_\_\_
7. \_\_\_\_\_
8. \_\_\_\_\_
9. \_\_\_\_\_

1. past entry price
2. past exit price
3. modified past amount
4. current entry price
5. current exit price
6. current equilibrium price
7. value in use
8. future entry price
9. future exit price

74. The FASB and IASB have joined forces to develop a joint Conceptual Framework. The joint task force's objective is to provide a sound foundation for both boards to develop accounting standards. This framework is essential to fulfilling the board's goal. What is the goal?

The Board's goal is to develop standards that are objectives based, internally consistent, and internationally converged and that lead to financial reporting that provides the information capital providers need to make capital allocation decisions.

75. FASB's Statements of Financial Accounting Concepts that are general proclamations. List two proclamations that form the basis of GAAP.

- fundamental principles of accounting
- objectives of financial reporting
- qualities of useful financial accounting information
- definitions of basic elements like assets and liabilities
- types of economic transactions, events, and arrangements to be recognized in financial statements.
- measurement attributes to use to measure and report these transactions, events, and arrangements.
- the presentation of the transactions, events, and arrangements within the financial statements.

76. What types of information would be helpful in accessing the amounts, timing, and uncertainty of future cash flows?

Return on investment  
Risk  
Financial flexibility  
liquidity  
operating capability

77. How is the information concerning the company's net income, comprehensive income and their components useful to external users?

- Evaluating management's performance
- Estimates the company's earning power
- Predict future income and net cash inflows
- Assess the risk of investor or lending to the company

78. Define the following terms as they relate to decision usefulness, the ultimate objective of accounting information.

- |    |                    |
|----|--------------------|
| a. | Relevance          |
| b. | Predictive value   |
| c. | Confirmatory value |
| d. | Materiality        |

- a. In relation to accounting information that would be pertinent, would make a difference in coming to a decision.
- b. The ability to form expectations about the future.
- c. Provides feedback to confirm or correct prior predictions or expectations about accounting information.
- d. The nature and magnitude of the inclusion or omissions of information in regards to financial statements. This is an entity specific characteristic.

79. The FASB and IASB describe four characteristics that enhance the decision usefulness of information that is relevant and faithfully represented. What are these characteristics and provide a brief explanation of each.

Comparability	Information must be able to be compared with similar information from other companies.
Verifiability	That other accountants, or users of the financial information can come to similar conclusions regarding the presentation of the information.
Timeliness	Information is presented to users in time to make valid and educated decisions.
Understandability	The information is comprehensible to users who have reasonable knowledge of the business and its economic activities.

80. List 5 of the important accounting assumptions that have had an impact on the development of GAAP and Accounting.

reporting entity  
 going concern  
 period of time assumption  
 monetary unit assumption  
 mixed attribute measurement model  
 historical cost  
 recognition principle  
 matching principle  
 expense recognition principle  
 conservatism



81. The Framework of Financial Accounting Theory and Practice is made up based upon several objectives. Provide a brief summary of one of these objectives.

Provide financial information about the reporting entity that is useful to existing and potential investors.

Provide useful information for decisions by existing and potential investors about buying, selling, or holding equity investments.

Provide useful information for decisions by existing and potential lenders about buying, selling, or holding debt instruments.

Provide existing and potential investors, lenders, and other creditors with the information to ascertain the amount, timing, and uncertainty of the prospects of future cash flows.

Provide information about changes in the company's economic resources and claims to those resources resulting from its financial performance.

82. Financial statements elements arranged in basic financial statements provide limited information for external users to ascertain the necessary information in which to base decisions upon. What are some other ways companies can disclose financial information to external users?

Notes to Financial Statements

- Accounting policies

- Contingencies

- Inventory Methods

Supplementary information

- Changing prices disclosures

- Oil and Gas Reserves Information

Other Means of Financial Reporting

- Management discussion and analysis

- Letters to Stockholders

Other Information

- Analyst Reports

- Economic Statistics

- News Articles about the company

83. List the three phases of the FASB and IASB convergence project that have been placed on hold in order in order that the two boards focus on finalizing convergence on several other topics.

Elements and Recognition

Measurement

Reporting Entity

84. At lunch recently, two accountants were discussing the merits of the FASB's conceptual framework project, which resulted in the publication of seven *Statements of Financial Accounting Concepts* and required more than ten years of effort. One accountant thought the effort was a waste of resources, since accounting was unlike physics, chemistry, and biology, where natural laws apply. The other accountant thought the effort was very valuable. He stated that "accounting, like any other discipline, benefits from having a coherent theory."

**Required:**

Write a brief essay that discusses the advantages that are derived from the existence of a conceptual framework for financial accounting and reporting.

The FASB's conceptual framework should result in the following advantages. It should "(1) guide the FASB in establishing accounting standards, (2) provide a framework for resolving accounting questions in situations where a standard doesn't currently exist, (3) determine the bounds for judgment in the preparation of financial statements, (4) increase users' understanding of and confidence in financial reporting, and (5) enhance comparability."

85. The task of developing the conceptual framework was so enormous that the FASB had to divide it into several projects.

**Required:**

Identify each of the projects by name and provide a brief description of their results.

The Objectives Project resulted in the issuance of Statements of Financial Accounting Concepts No. 1, "Objectives of Financial Reporting by Business Enterprises." The Accounting Projects provided definitions for the accounting elements, identification of which elements should be reported, when they should be recognized, and how they should be measured. The Reporting Projects dealt with how the elements of the financial statements are displayed, as well as what information should be provided, who should be required to provide the information, and where the information should be presented. Also dealt with were specific questions about income and cash flows. The Qualitative Characteristics Project provided SFAC No. 2, "Qualitative Characteristics of Accounting Information," which serves as a link between the Accounting and Reporting Projects.

86. GAAP lists and describes the qualitative characteristics that make accounting information useful for decision-making purposes. The FASB viewed the characteristics as a hierarchy of qualities that make accounting information useful. The FASB stated that accounting information must possess both relevance and faithful representation qualities to be useful, but it was noted that relevance and faithful representation may conflict with each other in some instances. For example, to increase relevance, faithful representation may have to be sacrificed, or vice versa.

**Required:**

- a. Define "relevance" and "faithful representation" and list the components or "ingredients" of each quality.
- b. Give an example in financial accounting that illustrates the following tradeoffs:
  - (1) Relevance is sacrificed in order to make accounting information more reliable.
  - (2) Faithful representation is sacrificed in order to make accounting information more relevant.

a. Relevance is defined as information that is capable of making a difference in the decision-making process. Relevant information helps users predict the outcomes of past, present, and future events or confirms or corrects prior expectations and is of the nature and magnitude that would influence judgment of a reasonable person relying on the information. The ingredients of relevance are (1) predictive value, (2) confirmatory value, and (3) materiality.

To be a faithful representation, information must be (1) complete, (2) neutral and (3) free from error.

- b. (1) The use of historical cost in financial accounting is an example of a sacrifice of relevance for reliability. Historical cost is reliable information, but it may not be as relevant as current cost information.
- (2) When a private company provides its own estimate of the fair value of its' stock. The value is relevant, but might not be a faithful representation of the stock's actual value.

87. The IASB/FASB tentative joint conceptual framework includes two "fundamental qualitative characteristics" that must be present for financial reporting information to be useful.

**Required:**

Name and describe the two joint conceptual framework fundamental characteristics.

1. Information must have the quality of relevance. Relevant information must be capable of making a difference in the decisions made by external users in their capacity as capital providers. To be relevant, information must have predictive value, confirmatory value, or both.
2. Information must have the quality of faithful representation. Faithful representation of economic phenomena occurs when the related information is complete, neutral, and free from material error.

88. Discuss the financial reporting model in the FASB Conceptual Framework.

FASB financial reporting model requires the four basic financial statements as listed below.

- balance sheet
- income statement
- statement of cash flows
- statement of shareholder's equity

Under GAAP the financial statements should contain notes to explain the different methodologies used to calculate estimates and policies. The statements should also contain supplementary items necessary to make an informed decision about the health and well being of the company. The model also suggests areas in which investors, creditors, and lenders can find additional company information.