Chapter 01

Environment and Theoretical Structure of Financial Accounting

**True / False Questions**

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

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

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| 3. | A rules-based approach to standard setting stresses professional judgment as opposed to following a list of rules.    True    False |

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| 4. | The primary responsibility for properly applying accounting standards when communicating with investors and creditors through financial statements lies with a firm's auditors.    True    False |

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| 5. | The IASB's conceptual framework provides accounting guidance when more specific accounting standards are not applicable.    True    False |

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| 6. | Materiality can be affected by the dollar amount of an item, the nature of the item, or both.    True    False |

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| 7. | Conservatism is a desired qualitative characteristic of accounting information.    True    False |

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| 8. | Comprehensive income is another term for net profit after tax.    True    False |

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| 9. | The statement of profit or loss summarizes the operating activity of a firm at a particular point in time.    True    False |

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| 10. | Determining fair value by calculating the present value of future cash flows is a level 1 type of input.    True    False |

**Multiple Choice Questions**

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| 11. | External decision makers would not look primarily to financial accounting information to assist them in making decisions on \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | granting credit |  |  |  | | --- | --- | | B. | capital budgeting |  |  |  | | --- | --- | | C. | selecting shares |  |  |  | | --- | --- | | D. | mergers and acquisitions | |

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| 12. | Which of the following groups is **not** among the external users for whom financial statements are prepared?      |  |  | | --- | --- | | A. | customers |  |  |  | | --- | --- | | B. | suppliers |  |  |  | | --- | --- | | C. | employees |  |  |  | | --- | --- | | D. | Customers, suppliers, and employees are all external users of financial statements. | |

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| 13. | Which of the following does **not** apply to secondary markets?      |  |  | | --- | --- | | A. | Transactions are important to the efficient allocation of resources in our economy. |  |  |  | | --- | --- | | B. | New resources are provided when shares are sold by the corporation to the initial owners. |  |  |  | | --- | --- | | C. | Transactions help to establish market prices for additional shares that may be issued in the future. |  |  |  | | --- | --- | | D. | Many investors might be unwilling to provide resources to corporations if there is no available mechanism for the future sale of their shares and bonds to others. | |

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| 14. | Which of the following is **not** true about net operating cash flow?      |  |  | | --- | --- | | A. | It is the difference between cash receipts and cash disbursements from providing goods and services. |  |  |  | | --- | --- | | B. | It is a measure used in accrual accounting and is recognized as the best predictor of future operating cash flows. |  |  |  | | --- | --- | | C. | Over short periods, it may not be indicative of long-run cash-generating ability. |  |  |  | | --- | --- | | D. | It is easy to understand and all information required to measure it is factual. | |

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| 15. | Which of the following is **not** a potential benefit of accrual accounting, compared to cash-basis accounting?      |  |  | | --- | --- | | A. | timeliness |  |  |  | | --- | --- | | B. | better reflecting economic activity |  |  |  | | --- | --- | | C. | periodicity |  |  |  | | --- | --- | | D. | better matching of revenues and expenses | |

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| 16. | The term "IFRS" usually refers to the following types of accounting standards: \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | Conceptual Framework and International Financial Reporting Standards |  |  |  | | --- | --- | | B. | interpretations issued by the IFRS Interpretations Committee |  |  |  | | --- | --- | | C. | International Accounting Standards |  |  |  | | --- | --- | | D. | all of these | |

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| 17. | The IASB's standard setting process includes, in the correct order, \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | exposure draft, research, discussion paper, standards |  |  |  | | --- | --- | | B. | research, exposure draft, discussion paper, standards |  |  |  | | --- | --- | | C. | research, discussion paper, exposure draft, standards |  |  |  | | --- | --- | | D. | discussion paper, research, exposure draft, standards | |

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| 18. | Which IASB organization enforces the use of IFRS?      |  |  | | --- | --- | | A. | the International Organization of Securities Commissions |  |  |  | | --- | --- | | B. | the Securities and Exchange Commission |  |  |  | | --- | --- | | C. | the Monitoring Board |  |  |  | | --- | --- | | D. | none of these | |

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| 19. | Accounting standard setting has been characterized as \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | a political process |  |  |  | | --- | --- | | B. | using the scientific method |  |  |  | | --- | --- | | C. | pure deductive reasoning |  |  |  | | --- | --- | | D. | pure inductive reasoning | |

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| 20. | The most recent example of the political process at work in IASB standard setting is the heated debate that occurred on the issue of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | pension plan accounting |  |  |  | | --- | --- | | B. | accounting for share-based compensation |  |  |  | | --- | --- | | C. | accounting for business combinations |  |  |  | | --- | --- | | D. | fair value accounting for financial assets and liabilities | |

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| 21. | The IASB's conceptual framework \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | emphasizes the overarching concept of the financial statements providing a "true and fair representation" of the company |  |  |  | | --- | --- | | B. | is not designed to provide guidance to standard setters, but rather only to practitioners |  |  |  | | --- | --- | | C. | is not designed to provide guidance to practitioners, but rather only to standard setters |  |  |  | | --- | --- | | D. | specifies a set of rules that determine what constitutes a true IFRS standard | |

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| 22. | The IASB's conceptual framework's qualitative characteristics of accounting information include \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | presentation and disclosure |  |  |  | | --- | --- | | B. | relevance |  |  |  | | --- | --- | | C. | going concern |  |  |  | | --- | --- | | D. | historical cost | |

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| 23. | The conceptual framework's qualitative characteristic of faithful representation includes \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | predictive value |  |  |  | | --- | --- | | B. | neutrality |  |  |  | | --- | --- | | C. | confirmatory value |  |  |  | | --- | --- | | D. | timeliness | |

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| 24. | Recognizing expected losses immediately, but deferring expected gains, is an example of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | materiality |  |  |  | | --- | --- | | B. | conservatism |  |  |  | | --- | --- | | C. | cost-effectiveness |  |  |  | | --- | --- | | D. | timeliness | |

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| 25. | Primecoat Corporation could disseminate its annual financial statements two days earlier if it shifted substantial human resources from other operations to the annual report project. Management decided the value of the earlier report was not worth the added commitment of resources. The concept demonstrated is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | timeliness |  |  |  | | --- | --- | | B. | materiality |  |  |  | | --- | --- | | C. | relevance |  |  |  | | --- | --- | | D. | cost-effectiveness | |

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| 26. | Four different competent accountants independently agree on the amount and method of reporting an economic event. The concept demonstrated is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | reliability |  |  |  | | --- | --- | | B. | comparability |  |  |  | | --- | --- | | C. | completeness |  |  |  | | --- | --- | | D. | verifiability | |

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| 27. | Gains are \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | inflows from selling a product or service to a customer |  |  |  | | --- | --- | | B. | increases in equity resulting from transfers of assets to the company from owners |  |  |  | | --- | --- | | C. | increases in equity from peripheral transactions of an entity |  |  |  | | --- | --- | | D. | none of these | |

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| 28. | Elements of financial statements do **not** include \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | monetary unit |  |  |  | | --- | --- | | B. | investments by owners |  |  |  | | --- | --- | | C. | comprehensive income |  |  |  | | --- | --- | | D. | losses | |

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| 29. | Change in equity from nonowner sources is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | comprehensive income |  |  |  | | --- | --- | | B. | revenues |  |  |  | | --- | --- | | C. | expenses |  |  |  | | --- | --- | | D. | gains and losses | |

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| 30. | The IASB's conceptual framework recognizes which one of the following as an assumption?      |  |  | | --- | --- | | A. | periodicity assumption |  |  |  | | --- | --- | | B. | monetary unit assumption |  |  |  | | --- | --- | | C. | going concern assumption |  |  |  | | --- | --- | | D. | economic entity assumption | |

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| 31. | If a company has declared bankruptcy, its financial statements likely violate \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | the fair value measurement approach |  |  |  | | --- | --- | | B. | the present value measurement approach |  |  |  | | --- | --- | | C. | the stable monetary unit assumption |  |  |  | | --- | --- | | D. | the going concern assumption | |

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| 32. | An important argument in support of historical cost information is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | relevance |  |  |  | | --- | --- | | B. | predictive quality for future cash flows |  |  |  | | --- | --- | | C. | materiality |  |  |  | | --- | --- | | D. | verifiability | |

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| 33. | Which of the following is **not** an identified valuation technique in IFRS regarding fair value measurement?      |  |  | | --- | --- | | A. | cost approach |  |  |  | | --- | --- | | B. | market approach |  |  |  | | --- | --- | | C. | cost-benefit approach |  |  |  | | --- | --- | | D. | income approach | |

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| 34. | Disclosure notes to a company's financial statements \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | are relatively unimportant facts that don't belong in the basic financial statements |  |  |  | | --- | --- | | B. | document the source of financial statement facts, like literary footnotes |  |  |  | | --- | --- | | C. | are an integral part of a company's financial statements |  |  |  | | --- | --- | | D. | are irrelevant facts that are immaterial in amount | |

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| 35. | The asset/liability approach emphasizes \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | whether amounts on the statement of financial position meet the definitions of assets and liabilities |  |  |  | | --- | --- | | B. | a close relation between the statement of financial position and the statement of cash flows |  |  |  | | --- | --- | | C. | the distinction between net assets and gross assets |  |  |  | | --- | --- | | D. | all of these | |

**Matching Questions**

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| 36. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Neutrality | Information is useful in projecting cash flows. | \_\_\_\_ | | 2. Predictive value | Pertinent to the decision at hand. | \_\_\_\_ | | 3. Timeliness | Information is unbiased. | \_\_\_\_ | | 4. Relevance | Information confirms expectations. | \_\_\_\_ | | 5. Confirmatory value | Information is available prior to the decision. | \_\_\_\_ | |

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| 37. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Comparability | The process of associating numerical amounts with the data in financial statements. | \_\_\_\_ | | 2. Consistency | Important in analysis between firms. | \_\_\_\_ | | 3. Recognition | Applying the same accounting practices over time. | \_\_\_\_ | | 4. Measurement | Considers the value of using information relative to cost of providing it. | \_\_\_\_ | | 5. Cost-effectiveness | The process of including data in financial statements. | \_\_\_\_ | |

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| 38. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Completeness | Basis of measurement for some assets. | \_\_\_\_ | | 2. Historical cost | Application of IFRS sometimes avoided under this constraint. | \_\_\_\_ | | 3. Revenue recognition | Contains all information necessary for faithful representation. | \_\_\_\_ | | 4. Materiality | Fundamental qualitative characteristic. | \_\_\_\_ | | 5. Faithful representation | Recognition of revenue only after certain criteria are satisfied. | \_\_\_\_ | |

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| 39. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Liabilities | Outflows of resources to generate revenues. | \_\_\_\_ | | 2. Equity | Net assets. | \_\_\_\_ | | 3. Expenses | Cash dividends. | \_\_\_\_ | | 4. Investments by owners | Transfers of resources in exchange for ordinary and preference shares. | \_\_\_\_ | | 5. Distributions to owners | Claims of creditors against the assets of a business. | \_\_\_\_ | |

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| 40. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Comprehensive income | Net outflows from peripheral transactions. | \_\_\_\_ | | 2. Losses | Probable future economic benefits controlled by an entity. | \_\_\_\_ | | 3. Gains | Increases in equity from the sale of goods and/or services. | \_\_\_\_ | | 4. Assets | All changes in equity except owner transactions. | \_\_\_\_ | | 5. Revenues | Results if an asset is sold for more than book value. | \_\_\_\_ | |

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| 41. | Listed below are eight organizations followed by a list of phrases that describe or characterize the organizations. Match each phrase with the correct organization.      |  |  |  | | --- | --- | --- | | 1. IASC | Regulates the financial reporting for public companies in the United States. | \_\_\_\_ | | 2. SEC | Sets accounting standards in the United States. | \_\_\_\_ | | 3. IFRS Advisory Council | Sets global accounting standards. | \_\_\_\_ | | 4. IASB | IASB's predecessor. | \_\_\_\_ | | 5. Monitoring Board | Provides timely responses to financial reporting issues. | \_\_\_\_ | | 6. FASB | Provides regulatory oversight to the IASB. | \_\_\_\_ | | 7. IFRS Interpretations Committee | Provides advice to the IASB on agenda and priorities. | \_\_\_\_ | | 8. IFRS Foundation | Provides funding for the IASB. | \_\_\_\_ | |

**Short Answer Questions**

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| 42. | Alpaca Corporation had revenues of $200,000 in its first year of operations. The company has not collected $20,000 of its sales and still owes $25,000 on $70,000 of merchandise it purchased. The company had no inventory on hand at the end of the year. The company paid $15,000 in salaries. Owners invested $20,000 in the business and $20,000 was borrowed on a five-year note. The company paid $2,000 in interest that was the amount owed for the year, and paid $6,000 for a two-year insurance policy on the first day of business. Alpaca has an effective income tax rate of 20%.  **Required:**  1. Compute net profit after tax for the first year for Alpaca Corporation. 2. Compute the cash balance at the end of the first year for Alpaca Corporation. |

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| 43. | The following information ($ in millions) comes from a recent annual report of Amazon.com, Inc.:     |  |  | | --- | --- | | Net sales | $10,711 | | Total assets | 4,363 | | End of year balance in cash | 1,022 | | Total shareholders' equity | 431 | | Gross profit (sales—cost of sales) | 2,456 | | Net increase in cash for the year | 9 | | Operating expenses | 2,067 | | Net operating cash flow | 702 | | Other income (expense), net | (12) |   **Required:**  1. Compute Amazon's balance in cash at the beginning of the year. 2. Compute Amazon's total liabilities at the end of the year. 3. Compute Amazon's cost of goods sold for the year. 4. Compute Amazon's profit before income tax for the year. |

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| 44. | The following information ($ in millions) comes from a recent annual report of Amazon.com, Inc.:   |  |  | | --- | --- | | Net sales | $10,711 | | Total assets | 4,363 | | End of year balance in cash | 1,022 | | Total shareholders' equity | 431 | | Gross profit (sales—cost of sales) | 2,456 | | Net increase in cash for the year | 9 | | Operating expenses | 2,067 | | Net operating cash flow | 702 | | Other income (expense), net | (12) |   **Required:**  Compare Amazon's profit (loss) for the year with its net cash flow from operating activities. Why are the amounts different? Briefly explain. |

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| 45. | For each of the following situations, state whether you agree or disagree with the financial reporting practice employed, and briefly explain the reason for your answer.  1. Cantor Corporation's accountant increased the book value of its inventory from its original cost of $1 million to its recently appraised value of $6 million. 2. Stanton Corporation paid for the personal travel of its chief financial officer and charged travel expense. 3. At the end of its 2022 financial year, Dower Ltd received an order from a customer for $60,000. The merchandise will ship early in 2023. Because the sale was made to a long-time customer and the invoice was paid in 2022, the controller recorded the sale in 2022. 4. In the middle of its 2022 financial year, Sanguinetti Ltd paid $12,000 to its insurance company for one-year comprehensive insurance coverage. Sanguinetti recorded the entire expenditure as an expense in 2022. 5. The Churchill Pharmaceutical Company included a note in its financial statements that described a pending lawsuit against the company. 6. The Daily Corporation, a company whose securities are publicly traded, prepares monthly, quarterly, and annual financial statements for internal use but disseminates to external users only the annual financial statements. |

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| 46. | What are the pros and cons of a principles-based approach to standard setting, compared with a rules-based approach? |

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| 47. | Accounting standards provide both broad and specific guidelines that companies should follow when measuring and reporting the information in their financial statements. Most industrialized countries have organizations responsible for determining accounting standards.  **Required:**  1. Why is it necessary to develop global accounting standards? 2. Accounting standard setting has been characterized as a political process. Discuss this proposition giving an example. |

Chapter 01 Environment and Theoretical Structure of Financial Accounting Answer Key

**True / False Questions**

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

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-01 Describe the function and primary focus of financial accounting. Topic: Environment of financial accounting and reporting* |

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

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| *AACSB: Reflective Thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 1 Easy Learning Objective: 01-02 Explain the difference between cash and accrual accounting. Topic: Cash versus accrual accounting* |

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| 3. | A rules-based approach to standard setting stresses professional judgment as opposed to following a list of rules.    **FALSE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process. Topic: Accounting standard-setting* |

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| 4. | The primary responsibility for properly applying accounting standards when communicating with investors and creditors through financial statements lies with a firm's auditors.    **FALSE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process. Topic: Encouraging high-quality financial reporting* |

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| 5. | The IASB's conceptual framework provides accounting guidance when more specific accounting standards are not applicable.    **TRUE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework. Topic: Purpose of conceptual framework* |

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| 6. | Materiality can be affected by the dollar amount of an item, the nature of the item, or both.    **TRUE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 7. | Conservatism is a desired qualitative characteristic of accounting information.    **FALSE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 8. | Comprehensive income is another term for net profit after tax.    **FALSE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Elements of financial statements* |

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| 9. | The statement of profit or loss summarizes the operating activity of a firm at a particular point in time.    **FALSE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Financial Statements* |

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| 10. | Determining fair value by calculating the present value of future cash flows is a level 1 type of input.    **FALSE** |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Concepts-Recognition - Measurement - Disclosure* |

**Multiple Choice Questions**

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| 11. | External decision makers would not look primarily to financial accounting information to assist them in making decisions on \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | granting credit |  |  |  | | --- | --- | | **B.** | capital budgeting |  |  |  | | --- | --- | | C. | selecting shares |  |  |  | | --- | --- | | D. | mergers and acquisitions | |

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| *AACSB: Reflective Thinking AICPA: BB Resource management Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 1 Easy Learning Objective: 01-01 Describe the function and primary focus of financial accounting. Topic: Environment of financial accounting and reporting* |

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| 12. | Which of the following groups is **not** among the external users for whom financial statements are prepared?      |  |  | | --- | --- | | A. | customers |  |  |  | | --- | --- | | B. | suppliers |  |  |  | | --- | --- | | C. | employees |  |  |  | | --- | --- | | **D.** | Customers, suppliers, and employees are all external users of financial statements. | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Risk analysis Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-01 Describe the function and primary focus of financial accounting. Topic: Environment of financial accounting and reporting* |

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| 13. | Which of the following does **not** apply to secondary markets?      |  |  | | --- | --- | | A. | Transactions are important to the efficient allocation of resources in our economy. |  |  |  | | --- | --- | | **B.** | New resources are provided when shares are sold by the corporation to the initial owners. |  |  |  | | --- | --- | | C. | Transactions help to establish market prices for additional shares that may be issued in the future. |  |  |  | | --- | --- | | D. | Many investors might be unwilling to provide resources to corporations if there is no available mechanism for the future sale of their shares and bonds to others. | |

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| *AACSB: Reflective Thinking AICPA: BB Resource management AICPA: FN Risk analysis Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-01 Describe the function and primary focus of financial accounting. Topic: Environment of financial accounting and reporting* |

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| 14. | Which of the following is **not** true about net operating cash flow?      |  |  | | --- | --- | | A. | It is the difference between cash receipts and cash disbursements from providing goods and services. |  |  |  | | --- | --- | | **B.** | It is a measure used in accrual accounting and is recognized as the best predictor of future operating cash flows. |  |  |  | | --- | --- | | C. | Over short periods, it may not be indicative of long-run cash-generating ability. |  |  |  | | --- | --- | | D. | It is easy to understand and all information required to measure it is factual. | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Explain the difference between cash and accrual accounting. Topic: Cash versus accrual accounting* |

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| 15. | Which of the following is **not** a potential benefit of accrual accounting, compared to cash-basis accounting?      |  |  | | --- | --- | | A. | timeliness |  |  |  | | --- | --- | | B. | better reflecting economic activity |  |  |  | | --- | --- | | **C.** | periodicity |  |  |  | | --- | --- | | D. | better matching of revenues and expenses | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 1 Easy Learning Objective: 01-02 Explain the difference between cash and accrual accounting. Topic: Cash versus accrual accounting* |

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| 16. | The term "IFRS" usually refers to the following types of accounting standards: \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | Conceptual Framework and International Financial Reporting Standards |  |  |  | | --- | --- | | B. | interpretations issued by the IFRS Interpretations Committee |  |  |  | | --- | --- | | C. | International Accounting Standards |  |  |  | | --- | --- | | **D.** | all of these | |

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| *AACSB: Reflective Thinking AICPA: BB Legal Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards. Topic: Development of accounting and reporting standards* |

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| 17. | The IASB's standard setting process includes, in the correct order, \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | exposure draft, research, discussion paper, standards |  |  |  | | --- | --- | | B. | research, exposure draft, discussion paper, standards |  |  |  | | --- | --- | | **C.** | research, discussion paper, exposure draft, standards |  |  |  | | --- | --- | | D. | discussion paper, research, exposure draft, standards | |

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| *AACSB: Reflective Thinking AICPA: BB Legal Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards. Topic: Standard-setting process* |

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| 18. | Which IASB organization enforces the use of IFRS?      |  |  | | --- | --- | | A. | the International Organization of Securities Commissions |  |  |  | | --- | --- | | B. | the Securities and Exchange Commission |  |  |  | | --- | --- | | C. | the Monitoring Board |  |  |  | | --- | --- | | **D.** | none of these | |

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| *AACSB: Reflective Thinking AICPA: BB Legal Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards. Topic: Development of accounting and reporting standards* |

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| 19. | Accounting standard setting has been characterized as \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | a political process |  |  |  | | --- | --- | | B. | using the scientific method |  |  |  | | --- | --- | | C. | pure deductive reasoning |  |  |  | | --- | --- | | D. | pure inductive reasoning | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process. Topic: Standard-setting process* |

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| 20. | The most recent example of the political process at work in IASB standard setting is the heated debate that occurred on the issue of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | pension plan accounting |  |  |  | | --- | --- | | B. | accounting for share-based compensation |  |  |  | | --- | --- | | C. | accounting for business combinations |  |  |  | | --- | --- | | **D.** | fair value accounting for financial assets and liabilities | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process. Topic: Standard-setting process* |

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| 21. | The IASB's conceptual framework \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | emphasizes the overarching concept of the financial statements providing a "true and fair representation" of the company |  |  |  | | --- | --- | | B. | is not designed to provide guidance to standard setters, but rather only to practitioners |  |  |  | | --- | --- | | C. | is not designed to provide guidance to practitioners, but rather only to standard setters |  |  |  | | --- | --- | | D. | specifies a set of rules that determine what constitutes a true IFRS standard | |

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| *AACSB: Diversity AICPA: BB Global Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-05 Explain the purpose of the IASB's conceptual framework. Topic: Purpose of conceptual framework* |

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| 22. | The IASB's conceptual framework's qualitative characteristics of accounting information include \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | presentation and disclosure |  |  |  | | --- | --- | | **B.** | relevance |  |  |  | | --- | --- | | C. | going concern |  |  |  | | --- | --- | | D. | historical cost | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 23. | The conceptual framework's qualitative characteristic of faithful representation includes \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | predictive value |  |  |  | | --- | --- | | **B.** | neutrality |  |  |  | | --- | --- | | C. | confirmatory value |  |  |  | | --- | --- | | D. | timeliness | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 24. | Recognizing expected losses immediately, but deferring expected gains, is an example of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | materiality |  |  |  | | --- | --- | | **B.** | conservatism |  |  |  | | --- | --- | | C. | cost-effectiveness |  |  |  | | --- | --- | | D. | timeliness | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 25. | Primecoat Corporation could disseminate its annual financial statements two days earlier if it shifted substantial human resources from other operations to the annual report project. Management decided the value of the earlier report was not worth the added commitment of resources. The concept demonstrated is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | timeliness |  |  |  | | --- | --- | | B. | materiality |  |  |  | | --- | --- | | C. | relevance |  |  |  | | --- | --- | | **D.** | cost-effectiveness | |

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| *AACSB: Reflective Thinking AICPA: BB Resource management Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 26. | Four different competent accountants independently agree on the amount and method of reporting an economic event. The concept demonstrated is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | reliability |  |  |  | | --- | --- | | B. | comparability |  |  |  | | --- | --- | | C. | completeness |  |  |  | | --- | --- | | **D.** | verifiability | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 27. | Gains are \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | inflows from selling a product or service to a customer |  |  |  | | --- | --- | | B. | increases in equity resulting from transfers of assets to the company from owners |  |  |  | | --- | --- | | **C.** | increases in equity from peripheral transactions of an entity |  |  |  | | --- | --- | | D. | none of these | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Elements of financial statements* |

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| 28. | Elements of financial statements do **not** include \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | monetary unit |  |  |  | | --- | --- | | B. | investments by owners |  |  |  | | --- | --- | | C. | comprehensive income |  |  |  | | --- | --- | | D. | losses | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Elements of financial statements* |

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| 29. | Change in equity from nonowner sources is \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | comprehensive income |  |  |  | | --- | --- | | B. | revenues |  |  |  | | --- | --- | | C. | expenses |  |  |  | | --- | --- | | D. | gains and losses | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Elements of financial statements* |

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| 30. | The IASB's conceptual framework recognizes which one of the following as an assumption?      |  |  | | --- | --- | | A. | periodicity assumption |  |  |  | | --- | --- | | B. | monetary unit assumption |  |  |  | | --- | --- | | **C.** | going concern assumption |  |  |  | | --- | --- | | D. | economic entity assumption | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-08 Describe the basic assumptions underlying the measurement and reporting of financial statement information. Topic: Basic assumptions* |

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| 31. | If a company has declared bankruptcy, its financial statements likely violate \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | the fair value measurement approach |  |  |  | | --- | --- | | B. | the present value measurement approach |  |  |  | | --- | --- | | C. | the stable monetary unit assumption |  |  |  | | --- | --- | | **D.** | the going concern assumption | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Create Difficulty: 2 Medium Learning Objective: 01-08 Describe the basic assumptions underlying the measurement and reporting of financial statement information. Topic: Basic assumptions* |

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| 32. | An important argument in support of historical cost information is \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | relevance |  |  |  | | --- | --- | | B. | predictive quality for future cash flows |  |  |  | | --- | --- | | C. | materiality |  |  |  | | --- | --- | | **D.** | verifiability | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 1 Easy Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Concepts-Recognition - Measurement - Disclosure* |

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| 33. | Which of the following is **not** an identified valuation technique in IFRS regarding fair value measurement?      |  |  | | --- | --- | | A. | cost approach |  |  |  | | --- | --- | | B. | market approach |  |  |  | | --- | --- | | **C.** | cost-benefit approach |  |  |  | | --- | --- | | D. | income approach | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Concepts-Recognition - Measurement - Disclosure* |

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| 34. | Disclosure notes to a company's financial statements \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | are relatively unimportant facts that don't belong in the basic financial statements |  |  |  | | --- | --- | | B. | document the source of financial statement facts, like literary footnotes |  |  |  | | --- | --- | | **C.** | are an integral part of a company's financial statements |  |  |  | | --- | --- | | D. | are irrelevant facts that are immaterial in amount | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Concepts-Recognition - Measurement - Disclosure* |

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| 35. | The asset/liability approach emphasizes \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | whether amounts on the statement of financial position meet the definitions of assets and liabilities |  |  |  | | --- | --- | | B. | a close relation between the statement of financial position and the statement of cash flows |  |  |  | | --- | --- | | C. | the distinction between net assets and gross assets |  |  |  | | --- | --- | | D. | all of these | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Evolving accounting standards* |

**Matching Questions**

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| 36. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Neutrality | Information is useful in projecting cash flows. | **2** | | 2. Predictive value | Pertinent to the decision at hand. | **4** | | 3. Timeliness | Information is unbiased. | **1** | | 4. Relevance | Information confirms expectations. | **5** | | 5. Confirmatory value | Information is available prior to the decision. | **3** | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Topic: Qualitative characteristics* |

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| 37. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Comparability | The process of associating numerical amounts with the data in financial statements. | **4** | | 2. Consistency | Important in analysis between firms. | **1** | | 3. Recognition | Applying the same accounting practices over time. | **2** | | 4. Measurement | Considers the value of using information relative to cost of providing it. | **5** | | 5. Cost-effectiveness | The process of including data in financial statements. | **3** | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Concepts-Recognition - Measurement - Disclosure Topic: Qualitative characteristics* |

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| 38. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Completeness | Basis of measurement for some assets. | **2** | | 2. Historical cost | Application of IFRS sometimes avoided under this constraint. | **4** | | 3. Revenue recognition | Contains all information necessary for faithful representation. | **1** | | 4. Materiality | Fundamental qualitative characteristic. | **5** | | 5. Faithful representation | Recognition of revenue only after certain criteria are satisfied. | **3** | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-06 Describe the objective and qualitative characteristics of financial reporting information. Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Concepts-Recognition - Measurement - Disclosure Topic: Qualitative characteristics* |

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| 39. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Liabilities | Outflows of resources to generate revenues. | **3** | | 2. Equity | Net assets. | **2** | | 3. Expenses | Cash dividends. | **5** | | 4. Investments by owners | Transfers of resources in exchange for ordinary and preference shares. | **4** | | 5. Distributions to owners | Claims of creditors against the assets of a business. | **1** | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Elements of financial statements* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 40. | Listed below are five terms followed by a list of phrases that describe or characterize the terms. Match each phrase with the correct term.      |  |  |  | | --- | --- | --- | | 1. Comprehensive income | Net outflows from peripheral transactions. | **2** | | 2. Losses | Probable future economic benefits controlled by an entity. | **4** | | 3. Gains | Increases in equity from the sale of goods and/or services. | **5** | | 4. Assets | All changes in equity except owner transactions. | **1** | | 5. Revenues | Results if an asset is sold for more than book value. | **3** | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-07 Describe the elements of financial statements and the four basic financial statements. Topic: Elements of financial statements* |

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| 41. | Listed below are eight organizations followed by a list of phrases that describe or characterize the organizations. Match each phrase with the correct organization.      |  |  |  | | --- | --- | --- | | 1. IASC | Regulates the financial reporting for public companies in the United States. | **2** | | 2. SEC | Sets accounting standards in the United States. | **6** | | 3. IFRS Advisory Council | Sets global accounting standards. | **4** | | 4. IASB | IASB's predecessor. | **1** | | 5. Monitoring Board | Provides timely responses to financial reporting issues. | **7** | | 6. FASB | Provides regulatory oversight to the IASB. | **5** | | 7. IFRS Interpretations Committee | Provides advice to the IASB on agenda and priorities. | **3** | | 8. IFRS Foundation | Provides funding for the IASB. | **8** | |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking AICPA: BB Legal Accessibility: Keyboard Navigation Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards. Topic: Development of accounting and reporting standards* |

**Short Answer Questions**

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| 42. | Alpaca Corporation had revenues of $200,000 in its first year of operations. The company has not collected $20,000 of its sales and still owes $25,000 on $70,000 of merchandise it purchased. The company had no inventory on hand at the end of the year. The company paid $15,000 in salaries. Owners invested $20,000 in the business and $20,000 was borrowed on a five-year note. The company paid $2,000 in interest that was the amount owed for the year, and paid $6,000 for a two-year insurance policy on the first day of business. Alpaca has an effective income tax rate of 20%.  **Required:**  1. Compute net profit after tax for the first year for Alpaca Corporation. 2. Compute the cash balance at the end of the first year for Alpaca Corporation.     (1)   |  |  |  | | --- | --- | --- | | Revenues |  | $200,000 | | Expenses: |  |  | | Cost of goods sold | 70,000 |  | | Salaries | 15,000 |  | | Interest | 2,000 |  | | Insurance | 3,000 | 90,000 | | Profit before tax |  | 110,000 | | Income tax at 20% |  | 22,000 | | Net profit after tax |  | $88,000 |    (2)   |  |  |  | | --- | --- | --- | | Cash receipts: |  |  | | Sales revenue | $200,000 |  | | Less: Accounts receivable | 20,000 | $180,000 | | Owners' investments |  | 20,000 | | Note payable |  | 20,000 | | Total receipts |  | 220,000 | | Cash disbursements: |  |  | | Purchases | 70,000 |  | | Less: Accounts payable | 25,000 | $45,000 | | Salaries paid |  | 15,000 | | Interest paid |  | 2,000 | | Insurance paid |  | 6,000 | | Estimated taxes paid |  | 22,000 | | Total cash disbursements |  | 90,000 | | Ending cash balance |  | $130,000 | |

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| *AACSB: Knowledge Application AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Apply Difficulty: 3 Hard Learning Objective: 01-02 Explain the difference between cash and accrual accounting. Topic: Cash versus accrual accounting* |

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| 43. | The following information ($ in millions) comes from a recent annual report of Amazon.com, Inc.:     |  |  | | --- | --- | | Net sales | $10,711 | | Total assets | 4,363 | | End of year balance in cash | 1,022 | | Total shareholders' equity | 431 | | Gross profit (sales—cost of sales) | 2,456 | | Net increase in cash for the year | 9 | | Operating expenses | 2,067 | | Net operating cash flow | 702 | | Other income (expense), net | (12) |   **Required:**  1. Compute Amazon's balance in cash at the beginning of the year. 2. Compute Amazon's total liabilities at the end of the year. 3. Compute Amazon's cost of goods sold for the year. 4. Compute Amazon's profit before income tax for the year.     1. Beginning balance in Cash = Ending balance in Cash − Net increase in Cash = $1,022 − 9 = $1,013    2. Total liabilities = Total assets − Total shareholders' equity = $4,363 − $431 = $3,932    3. Cost of goods sold = Net sales − Gross profit = $10,711 − $2,456 = $8,255    4. Profit before tax = Gross profit − Operating expenses + Other income (expense), net = $2,456 − 2,067 + (12) = $377 |

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| *AACSB: Knowledge Application AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Apply Difficulty: 2 Medium Learning Objective: 01-02 Explain the difference between cash and accrual accounting. Topic: Cash versus accrual accounting* |

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| 44. | The following information ($ in millions) comes from a recent annual report of Amazon.com, Inc.:   |  |  | | --- | --- | | Net sales | $10,711 | | Total assets | 4,363 | | End of year balance in cash | 1,022 | | Total shareholders' equity | 431 | | Gross profit (sales—cost of sales) | 2,456 | | Net increase in cash for the year | 9 | | Operating expenses | 2,067 | | Net operating cash flow | 702 | | Other income (expense), net | (12) |   **Required:**  Compare Amazon's profit (loss) for the year with its net cash flow from operating activities. Why are the amounts different? Briefly explain.     These amounts are different because of the differences between cash and accrual accounting. As opposed to cash flows from operations, net profit includes both revenues and expenses, the timing of which differs from the timing of certain cash receipts and payments. Examples would be credit sales in which the revenues are recorded before the collection of cash and cost of goods sold in which the expense is often recorded later than the cash payment to the supplier for the merchandise. |

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| *AACSB: Communication AACSB: Reflective Thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-02 Explain the difference between cash and accrual accounting. Topic: Cash versus accrual accounting* |

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| 45. | For each of the following situations, state whether you agree or disagree with the financial reporting practice employed, and briefly explain the reason for your answer.  1. Cantor Corporation's accountant increased the book value of its inventory from its original cost of $1 million to its recently appraised value of $6 million. 2. Stanton Corporation paid for the personal travel of its chief financial officer and charged travel expense. 3. At the end of its 2022 financial year, Dower Ltd received an order from a customer for $60,000. The merchandise will ship early in 2023. Because the sale was made to a long-time customer and the invoice was paid in 2022, the controller recorded the sale in 2022. 4. In the middle of its 2022 financial year, Sanguinetti Ltd paid $12,000 to its insurance company for one-year comprehensive insurance coverage. Sanguinetti recorded the entire expenditure as an expense in 2022. 5. The Churchill Pharmaceutical Company included a note in its financial statements that described a pending lawsuit against the company. 6. The Daily Corporation, a company whose securities are publicly traded, prepares monthly, quarterly, and annual financial statements for internal use but disseminates to external users only the annual financial statements.     1. Disagree. This is a violation of the historical cost (original transaction value) principle. 2. Disagree. This is a violation of the economic entity assumption. 3. Disagree. The seller has not satisfied its performance obligation to deliver goods to the customer. 4. Disagree. This is a violation of expense recognition concepts. 5. Agree. This is consistent with presentation and disclosure concepts. 6. Disagree. This is a violation of the periodicity assumption and the qualitative characteristic of timeliness. |

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| *AACSB: Analytical Thinking AICPA: BB Critical thinking AICPA: FN Measurement Accessibility: Keyboard Navigation Blooms: Analyze Difficulty: 2 Medium Learning Objective: 01-08 Describe the basic assumptions underlying the measurement and reporting of financial statement information. Learning Objective: 01-09 Describe the recognition, measurement, and presentation and disclosure concepts that guide accounting practice. Topic: Basic assumptions Topic: Concepts-Recognition - Measurement - Disclosure* |

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| 46. | What are the pros and cons of a principles-based approach to standard setting, compared with a rules-based approach?     A principles-based approach emphasizes using professional judgment to interpret broad principles and concepts and apply them to various situations, as opposed to following a list of detailed rules, when choosing the accounting treatment for a transaction.  A principles-based approach may result in a more accurate reflection of the true economic substance of a company's transactions and actual performance in the financial statements, because a focus on professional judgment means a lower likelihood of companies structuring transactions to circumvent the accounting rules, and we are more likely to arrive at an appropriate accounting treatment. A principles-based approach may also result in shorter and less complex standards.  However, the absence of detailed rules in a principles-based approach may open the door to even more abuse, because management can use the latitude provided by objectives to justify their preferred accounting approach. Even in the absence of intentional misuse, reliance on professional judgment might result in different interpretations for similar transactions, raising concerns about comparability and consistency. Also, detailed rules help auditors to withstand pressure from clients who want a more favorable accounting treatment, and help companies ensure that they are complying with accounting standards and avoid litigation. |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process. Topic: Encouraging high-quality financial reporting* |

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| 47. | Accounting standards provide both broad and specific guidelines that companies should follow when measuring and reporting the information in their financial statements. Most industrialized countries have organizations responsible for determining accounting standards.  **Required:**  1. Why is it necessary to develop global accounting standards? 2. Accounting standard setting has been characterized as a political process. Discuss this proposition giving an example.     1. The accounting standards set by the standard setting organizations in various countries are not the same due to differences in legal systems, inflation rate, degrees of sophistication and use of capital markets, use of financial reports by tax or government authorities, and political and economic ties with other countries. These differences affect comparability in financial information and impair the ability of companies to raise capital in international markets. It is also difficult for multinational corporations to comply with a few different sets of accounting standards. These differences also cause problems for investors who are comparing companies whose financial statements are prepared using different standards. Hence, it is necessary to develop global accounting standards to help participants in worldwide capital markets and other users to make economic decisions. 2. Changes in accounting standards can have significant differential effects on companies, investors, creditors, and other interest groups. The IASB must gauge the economic consequences of a change in accounting standards. The process by which financial accounting standards are created includes public comment and sometimes hearings. Ultimately, a vote must be taken to pass a proposed change in IFRS. For example, accounting for financial instruments and fair value accounting for financial assets and liabilities are examples where accounting practices have been affected by political influences on IFRS. |

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| *AACSB: Reflective Thinking AICPA: BB Critical thinking Accessibility: Keyboard Navigation Blooms: Understand Difficulty: 2 Medium Learning Objective: 01-03 Define accounting standards and discuss the historical development of accounting standards, including convergence between U.S. and international standards. Learning Objective: 01-04 Explain why the establishment of accounting standards is characterized as a political process. Topic: Accounting standard-setting* |