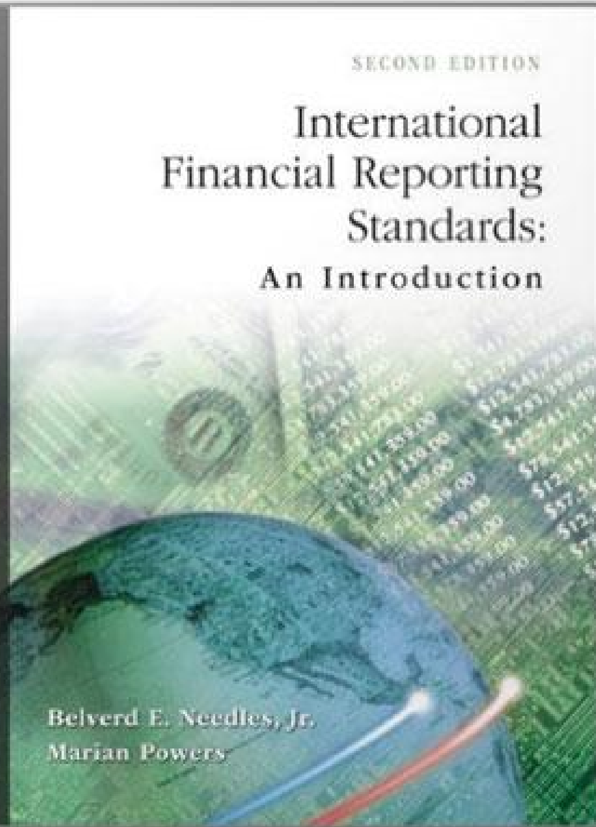
SOLUTIONS MANUAL



CHAPTER 2

1. **What are IFRS and how do they relate to IAS?**
   IASB achieves its objectives primarily by developing and publishing IFRS and promoting the use of those standards in general purpose financial statements and other financial reporting. To aid in the development of future IAS and in the review of existing IAS, the IASC issued the *Framework for the Preparation and Presentation of Financial Statements* for external users. The IASB continues to rely on the framework in setting IFRS.
2. **What is the objective of financial statements and what two assumptions underlie them?**
   The objective of financial statements is to provide information about the financial position, performance, and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.
   Two assumptions underlying financial statements are accrual accounting and going concern.
3. **Why are qualitative characteristics important?**
   Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. Therefore, the four principal qualitative characteristics, understandability, relevance, reliability, comparability enhance the usefulness of financial statements.
4. **What is the difference between understandability and relevance?**
   Information has the quality of understandability if users readily understand it. Users are assumed to have a reasonable knowledge of business, economic activities, and accounting as well as a willingness to study the information with reasonable diligence. Information has the quality of relevance when it influences users' economic decisions. However, relevant information about complex matters should not be excluded merely on the grounds that it may be too difficult for certain users to understand.
5. **Is reliability the same as accuracy?**
   Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. Reliability does not imply precise measurements of the elements of financial statements. Accuracy means the financial statements are totally free from errors. Reliability could not guarantee the accuracy, but definitely could provide

the readers the confidence of dependability.

6. **What are the characteristics of reliability?**
   The characteristics of reliability are: faithful representation, substance over form, neutrality, prudence.
7. **What is comparability and to what does it apply?**
   The quality of comparability means users may compare the financial statements of an entity through time in order to identify trends and also compare the financial statements of different entities in order to evaluate their relative financial position, performance, and changes in financial position.
8. **What are assets, liabilities, and equity? Define each.**
   Asset: A resource controlled by the entity as a result of past events and from which future economic benefits
   Liability: A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
   Equity: The residual interest in the assets of the entity after deducting all its liabilities.
9. **What are venues and expenses? Define each.**
   Income: The increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
   Expenses: Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.
10. **What are measurement, recognition, and derecognition? Define each and tell how they relate to each other?**

    Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the following criteria: It is probable that any future economic benefit associated with the item will flow to or from the entity; and the item has a cost or value that can be measured with reliability.
    Derecognition is the removal of a previously recognized asset or liability from an entity's

statement of financial position.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and income statement.

So accountants have to measure value of items, and the recognize them the financial statements. If there are no more future economic benefits made by this item, accountants need to derecognize it from the financial statements.

11. **List the five sections that all proposed financial statements should contain.**

All statements will be divided into five categories as follows:

Business: Includes line items related to operating and investing activities.

Financing: Includes line items related to financing activities.

Income taxes

Discontinued operations

Equity

12. **How does the balance sheet under proposed IFRS differ from U.S. GAAP?**

GAAP and IFRS have pretty similar format in balance, which IFRS named as statement of financial position. IFRS do not prescribe a format for the statement of financial position. IFRS require the separation of current and non-current assets, and current and non-current liabilities and that they be listed in order of liquidity. In contrast to U.S. practice, IFRS specifically prohibit "deferred tax assets/liabilities".

13. **What is the proposed new name for the income statement and why does it have this name?**

The new name is Statement of Comprehensive Income. The title includes the words comprehensive income, indicating it will include items that previously were disclosed separately as other comprehensive income.

14. **How does the proposed IFRS statement of cash flows differ from the way most of these statements are prepared in the United States?**

In a significant difference from U.S. GAAP, IFRS exclud**e** non-cash investing and financing activities from the statement of cash flows. Entities disclose the relevant information related to these transactions in the notes to financial statements.

15. **What does the proposed schedule in Exhibit 5 reconcile and why is it useful?**

The reconciliation can clearly show the five sections in all of financial statements, Business, financing, Income Tax, Discontinued operations, Equity. Then accountants can easily see what goes into each category and explains its choices in the accounting policy note to the financial statements.

16. **Class or group discussion: Is historical cost or fair value more in line with the qualitative characteristics of the conceptual framework and why?**

Fair value underlies the measurement of all items under IFRS. Fair value underlies the measurement of all items under IFRS. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable parties in an arm's length transaction. A measure of value used in accounting in which the price of an asset on the balance sheet is based on its nominal or original cost when acquired by the company. Based on the historical-cost principle, under U.S. GAAP, most assets held on the balance sheet are to be recorded at the historical cost even if they have significantly changed in value over time. Therefore, in order to fitting into the neutrality, comparability characteristics in IFRS, Fair value is more appropriate.

17. ***Class or group discussion*: Define the concepts of *conservatism* under U.S. GAAP and *prudence* under IFRS. How are they similar and how are they different? Do they represent a significant difference between U.S. GAAP and IFRS? Give an example of how they might differ in their application.**

The principle of conservatism in GAAP provides that accounting for a business should be fair and reasonable. Accountants are required in their work to make evaluations and estimates, to deliver opinions, and to select procedures. They should do so in a way that neither overstates nor understates the affairs of the business or the results of operation. In IFRS, to be prudent, a degree of caution in the exercise of the judgments is needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. They do not represent a significant difference between GAAP and IFRS. They both mean the cautious side in accounting area. I didn't quite see the difference.

18. Exercise: **Match the selected sections of IASB-proposed financial statements (letters) with their respective components (numbers):**

1) E 2) D 3) G 4) B 5) A

6) E 7) F 8) C 9) D 10) A

11) F 12) C 13) G 14) A

19. Exercise: **Match the selected sections of IASB-proposed statement of comprehensive**

income statement (letters) with their respective components (numbers).

1) B 2) F 3) I 4) B 5) E

6) C 7) D 8) F 9) D 10) G

11) D 12) I 13) H 14) D 15) B

16) I 17) A

20. ***Exercise:*** **Match the selected sections of IASB-proposed statement of financial position (letters) with their respective components (numbers).**

1) D 2) F 3) A 4) C 5) E

6) A 7) C 8) A 9) G 10) H

11) A 12) B 13) G 14) C 15) B

16) G 17) C

21. ***Case:*** **Assume you work for a company that has used the U.S. GAAP practice of valuing Buildings at historical cost less accumulated depreciation. Your company is considering revaluing the building annually based on fair value. Based on the concepts underlying the IFRS framework, how does fair value differ from historical cost. (Use the example of fair value presented in the text as a starting point.)**

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable parties in an arm's length transaction. According to one former member of the IASB, fair values

- Are *relevant*
- Have *predictive value*
- Can be *faithful representations* of assets and liabilities
- Are *neutral*
- Are *timely*
- Are *comparable*
- Enhance *consistency*, a dimension of comparability, because they reflect the same type of information every period

However, historical cost could not change following with the change in market. Therefore, if the company is in the country adopting IFRS, definitely this company need to use fair value method instead of GAAP for the best quality to present for investors.