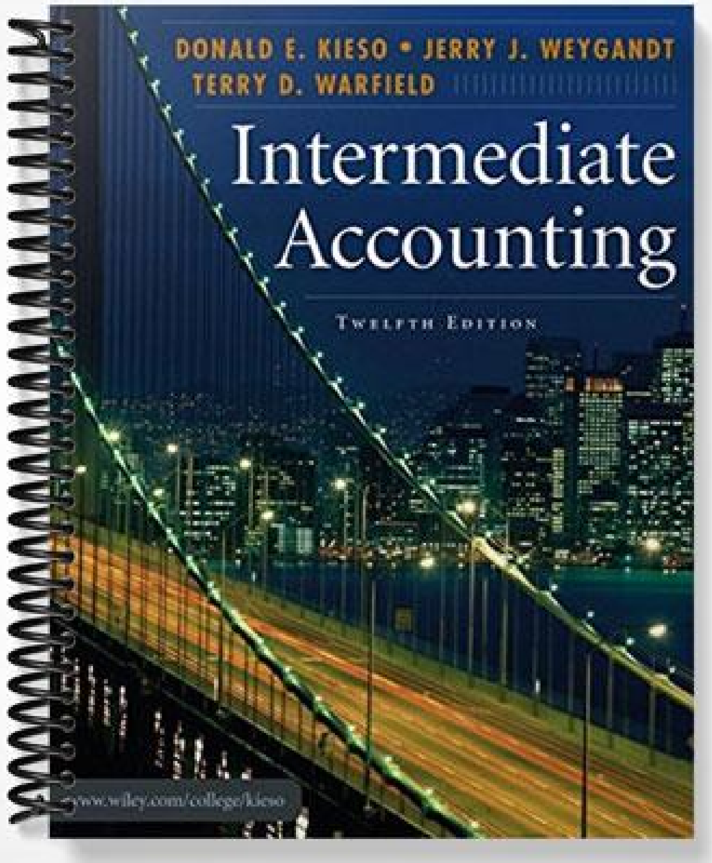
TEST BANK


DONALD E. KIESO • JERRY J. WEYGANDT
TERRY D. WARFIELD
Intermediate
Accounting
TWELFTH EDITION
www.wiley.com/college/kieso

CHAPTER 2

CONCEPTUAL FRAMEWORK UNDERLYING FINANCIAL ACCOUNTING

TRUE-FALSE—Conceptual

Answer	No.	Description
F	1.	Nature of conceptual framework.
T	2.	Conceptual framework definition.
F	3.	Levels of conceptual framework.
T	4	International conceptual framework.
F	5.	Statements of Financial Accounting Concepts.
T	6.	Decision usefulness.
F	7.	Financial statement users.
T	8.	Relevance and reliability.
T	9.	Consistency.
F	10.	Relevance.
F	11.	Reliability.
F	12.	Basic elements.
T	13.	Comprehensive income.
T	14.	Going concern assumption.
F	15.	Economic entity assumption.
F	16.	Matching principle.
T	17.	Realizable revenues.
T	18.	Supplementary information.
F	19.	Materiality factors
F	20.	Conservatism.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
c	21.	GAAP defined.
d	22.	Purpose of conceptual framework.
c	23.	Conceptual framework.
d	[S]24.	Conceptual framework benefits.
d	25.	Objectives of financial reporting.
a	26.	Decision usefulness.
d	27.	Objectives of financial reporting.
a	[P]28.	Financial repoting objectives.
c	29.	Purpose of understandable information.
a	30.	Decision-usefulness criterion.
c	31.	Primary qualities of accounting information.
b	32.	Definition of relevance.
b	33.	Definition of reliability.
d	34.	Relevance and reliability.
c	35.	Timeliness characteristic.

MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
d	36.	Verifiability characteristic.
b	37.	Neutrality characteristic.
d	38.	Neutrality characteristic.
c	39.	Definition of verifiability.
a	40.	Quality of predictive value.
c	41.	Quality of representational faithfulness.
d	42.	Consistency.
b	43.	Consistency characteristic.
b	44.	Comparability and consistency.
d	45.	Comparability.
d	46.	Elements of financial statements.
c	47.	Distinction between revenues and gains.
c	48.	Definition of a loss.
d	49.	Definition of comprehensive income.
b	50.	Components of comprehensive income.
d	P51.	Comprehensive income.
b	S52.	Earnings vs. comprehensive income.
a	S53.	Reporting financial statement elements.
a	S54.	Monetary unit assumption.
c	S55.	Periodicity assumption.
c	56.	Monetary unit assumption.
d	57.	Economic entity assumption.
a	58.	Economic entity assumption.
b	59.	Periodicity assumption.
a	60.	Going concern assumption.
d	61.	Going concern assumption.
d	62.	Implications of going concern assumption.
a	63.	Historical cost principle.
d	64.	Historical cost principle.
c	65.	Revenue recognition principle.
d	66.	Revenue recognition principle.
d	67.	Revenue recognition principle.
d	68.	Timing of revenue recognition.
c	69.	Realization concept.
b	70.	Definition of realized.
b	71.	Matching principle.
b	72.	Matching principle.
b	73.	Expense recognition.
c	74.	Full-disclosure principle.
d	75.	Constraints to limit the cost of reporting.
a	76.	Cost-benefit constraint.
c	77.	Materiality constraint.
d	78.	Materiality.
d	79.	Pervasive constraints.
a	80.	Conservatism constraint.
b	81.	Conservatism constraint.
a	82.	Trade-offs between characteristics of accounting information.
c	83.	Trade-offs between characteristics of accounting information.
c	P84.	Conservatism constraint.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
a	85.	Quality of predictive value.
b	86.	Consistency characteristic.
b	87.	Classification of gains and losses.
b	88.	Earnings concept.
a	89.	Components of comprehensive income.
b	90.	Components of comprehensive income.
d	91.	Components of comprehensive income.
d	92.	Components of comprehensive income.
a	93.	Definition of recognition.

[P] Note: these questions also appear in the Problem-Solving Survival Guide.
[S] Note: these questions also appear in the Study Guide.

EXERCISES

Item	Description
E2-94	Examination of the conceptual framework.
E2-95	Accounting concepts—identification.
E2-96	Accounting concepts—identification.
E2-97	Accounting concepts—matching.
E2-98	Accounting concepts—fill in the blanks.
E2-99	Basic assumptions.
E2-100	Revenue recognition.
E2-101	Historical cost principle.
E2-102	Matching concept.

CHAPTER LEARNING OBJECTIVES

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

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	2.	TF	21.	MC	22.	MC	23.	MC	[S]24.	MC	94.	E
Learning Objective 2													
3.	TF	4.	TF	5.	TF	25.	MC	94.	E				
Learning Objective 3													
6.	TF	7.	TF	26.	MC	27.	MC	[P]28.	MC	94.	E		
Learning Objective 4													
8.	TF	29.	MC	33.	MC	37.	MC	41.	MC	45.	MC	96.	E
9.	TF	30.	MC	34.	MC	38.	MC	42.	MC	85.	MC	97.	E
10.	TF	31.	MC	35.	MC	39.	MC	43.	MC	86.	MC	98.	E
11.	TF	32.	MC	36.	MC	40.	MC	44.	MC	95.	E		
Learning Objective 5													
12.	TF	47.	MC	50.	MC	[S]53.	MC	89.	MC	92.	MC		
13.	TF	48.	MC	[P]51.	MC	87.	MC	90.	MC				
46.	MC	49.	MC	[S]52.	MC	88.	MC	91.	MC				
Learning Objective 6													
14.	TF	[S]55.	MC	58.	MC	61.	MC	98.	E	101.	E		
15.	TF	56.	MC	59.	MC	62.	MC	99.	E				
[S]54.	MC	57.	MC	60.	MC	95.	E	100.	E				
Learning Objective 7													
16.	TF	64.	MC	68.	MC	72.	MC	95.	E	100.	E		
17.	TF	65.	MC	69.	MC	73.	MC	96.	E	101.	E		
18.	TF	66.	MC	70.	MC	74.	MC	97.	E	102.	E		
63.	MC	67.	MC	71.	MC	93.	MC	98.	E				
Learning Objective 8													
19.	TF	75.	MC	77.	MC	79.	MC	81.	MC	83.	MC	95.	E
20.	TF	76.	MC	78.	MC	80.	MC	82.	MC	[P]84.	MC	96.	E

Note: TF = True-False
MC = Multiple Choice
E = Exercise

TRUE-FALSE—Conceptual

1. The conceptual framework for accounting has been discovered through empirical research.
2. A conceptual framework is a coherent system of interrelated objectives and fundamentals that can lead to consistent standards.
3. The first level of the conceptual framework identifies the recognition and measurement concepts used in establishing accounting standards.
4. The IASB has issued a conceptual framework that is broadly consistent with that of the United States.
5. Although the FASB intends to develop a conceptual framework, no Statements of Financial Accounting Concepts have been issued to date.
6. Decision Usefulness is the underlying theme of the conceptual framework.
7. Users of financial statements are assumed to have no knowledge of business and financial accounting matters by financial statement preparers.
8. Relevance and reliability are the two primary qualities that make accounting information useful for decision making.
9. The idea of consistency does not mean that companies cannot switch from one accounting method to another.
10. Timeliness and neutrality are two ingredients of relevance.
11. Verifiability and predictive value are two ingredients of reliability.
12. Revenues, gains, and distributions to owners all increase equity.
13. Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.
14. The historical cost principle would be of limited usefulness if not for the going concern assumption.
15. The economic entity assumption means that economic activity can be identified with a particular legal entity.
16. The matching principle states that debits must equal credits in each transaction.
17. Revenues are realizable when assets received or held are readily convertible into cash or claims to cash.
18. Supplementary information may include details or amounts that present a different perspective from that adopted in the financial statements.
19. Companies consider only quantitative factors in determining whether an item is material.

20. Conservatism in accounting means the accountant should attempt to understate assets and income when possible.

True False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	6.	T	11.	F	16.	F
2.	T	7.	F	12.	F	17.	T
3.	F	8.	T	13.	T	18.	T
4.	T	9.	T	14.	T	19.	F
5.	F	10.	F	15.	F	20.	F

MULTIPLE CHOICE—Conceptual

21. Generally accepted accounting principles
    a. are fundamental truths or axioms that can be derived from laws of nature.
    b. derive their authority from legal court proceedings.
    c. derive their credibility and authority from general recognition and acceptance by the accounting profession.
    d. have been specified in detail in the FASB conceptual framework.

22. A soundly developed conceptual framework of concepts and objectives should
    a. increase financial statement users' understanding of and confidence in financial reporting.
    b. enhance comparability among companies' financial statements.
    c. allow new and emerging practical problems to be more quickly soluble.
    d. all of these.

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

[S]24. Which of the following is not a benefit associated with the FASB Conceptual Framework Project?
    a. A conceptual framework should increase financial statement users' understanding of and confidence in financial reporting.
    b. Practical problems should be more quickly solvable by reference to an existing conceptual framework.
    c. A coherent set of accounting standards and rules should result.
    d. Business entities will need far less assistance from accountants because the financial reporting process will be quite easy to apply.

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

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

27. Which of the following is *not* an objective of financial reporting?
    a. To provide information about economic resources, the claims to those resources, and the changes in them.
    b. To provide information that is helpful to investors and creditors and other users in assessing the amounts, timing, and uncertainty of future cash flows.
    c. To provide information that is useful to those making investment and credit decisions.
    d. All of these are objectives of financial reporting.

P28. The objectives of financial reporting include all of the following except to provide information that
    a. is useful to the Internal Revenue Service in allocating the tax burden to the business community.
    b. is useful to those making investment and credit decisions.
    c. is helpful in assessing future cash flows.
    d. identifies the economic resources (assets), the claims to those resources (liabilities), and the changes in those resources and claims.

29. Decision makers vary widely in the types of decisions they make, the methods of decision making they employ, the information they already possess or can obtain from other sources, and their ability to process information. Consequently, for information to be useful there must be a linkage between these users and the decisions they make. This link is
    a. relevance.
    b. reliability.
    c. understandability.
    d. materiality.

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

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

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

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

34. According to *Statement of Financial Accounting Concepts No. 2,* which of the following relates to both relevance and reliability?
    a. Materiality
    b. Understandability
    c. Usefulness
    d. All of these

35. According to *Statement of Financial Accounting Concepts No. 2,* timeliness is an ingredient of the primary quality of

	Relevance	Reliability
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

36. According to *Statement of Financial Accounting Concepts No. 2,* verifiability is an ingredient of the primary quality of

	Relevance	Reliability
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

37. According to *Statement of Financial Accounting Concepts No. 2,* neutrality is an ingredient of the primary quality of

	Relevance	Reliability
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

38. Information is neutral if it
    a. provides benefits which are at least equal to the costs of its preparation.
    b. can be compared with similar information about an enterprise at other points in time.
    c. would have no impact on a decision maker.
    d. is free from bias toward a predetermined result.

39. The characteristic that is demonstrated when a high degree of consensus can be secured among independent measurers using the same measurement methods is
    a. relevance.
    b. reliability.
    c. verifiability.
    d. neutrality.

40. According to *Statement of Financial Accounting Concepts No. 2,* predictive value is an ingredient of the primary quality of

	Relevance	Reliability
a.	Yes	No
b.	Yes	Yes
c.	No	No
d.	No	Yes

41. Under *Statement of Financial Accounting Concepts No. 2,* representational faithfulness is an ingredient of the primary quality of

	Reliability	Relevance
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

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

43. Financial information exhibits the characteristic of consistency when
    a. expenses are reported as charges against revenue in the period in which they are paid.
    b. accounting entities give accountable events the same accounting treatment from period to period.
    c. extraordinary gains and losses are not included on the income statement.
    d. accounting procedures are adopted which give a consistent rate of net income.

44. Information about different entities and about different periods of the same entity can be prepared and presented in a similar manner. Comparability and consistency are related to which of these objectives?

	Comparability	Consistency
a.	Entities	Entities
b.	Entities	Periods
c.	Periods	Entities
d.	Periods	Periods

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

46. The elements of financial statements include investments by owners. These are increases in an entity's net assets resulting from owners'
   a. transfers of assets to the entity.
   b. rendering services to the entity.
   c. satisfaction of liabilities of the entity.
   d. all of these.

47. In classifying the elements of financial statements, the primary distinction between revenues and gains is
   a. the materiality of the amounts involved.
   b. the likelihood that the transactions involved will recur in the future.
   c. the nature of the activities that gave rise to the transactions involved.
   d. the costs versus the benefits of the alternative methods of disclosing the transactions involved.

48. A decrease in net assets arising from peripheral or incidental transactions is called a(n)
   a. capital expenditure.
   b. cost.
   c. loss.
   d. expense.

49. One of the elements of financial statements is comprehensive income. As described in *Statement of Financial Accounting Concepts No. 6,* "Elements of Financial Statements," comprehensive income is equal to
   a. revenues minus expenses plus gains minus losses.
   b. revenues minus expenses plus gains minus losses plus investments by owners minus distributions to owners.
   c. revenues minus expenses plus gains minus losses plus investments by owners minus distributions to owners plus assets minus liabilities.
   d. none of these.

50. Which of the following elements of financial statements is not a component of comprehensive income?
   a. Revenues
   b. Distributions to owners
   c. Losses
   d. Expenses

P51. Which of the following is false with regard to the element "comprehensive income"?
   a. It is more inclusive than the traditional notion of net income.
   b. It includes net income and all other changes in equity exclusive of owners' investments and distributions to owners.
   c. This concept is not yet being applied in practice.
   d. It excludes prior period adjustments (transactions that relate to previous periods, such as corrections of errors).

S52. According to the FASB conceptual framework, earnings
a. are the same as comprehensive income.
b. exclude certain gains and losses that are included in comprehensive income.
c. include certain gains and losses that are excluded from comprehensive income.
d. include certain losses that are excluded from comprehensive income.

S53. According to the FASB Conceptual Framework, the elements—assets, liabilities, and equity—describe amounts of resources and claims to resources at/during a

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

S54. Which of the following basic accounting assumptions is threatened by the existence of severe inflation in the economy?
a. Monetary unit assumption.
b. Periodicity assumption.
c. Going-concern assumption.
d. Economic entity assumption.

S55. During the lifetime of an entity accountants produce financial statements at artificial points in time in accordance with the concept of

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

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

57. The economic entity assumption
a. is inapplicable to unincorporated businesses.
b. recognizes the legal aspects of business organizations.
c. requires periodic income measurement.
d. is applicable to all forms of business organizations.

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

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

60. What accounting concept justifies the usage of accruals and deferrals?
    a. Going concern assumption
    b. Materiality constraint
    c. Consistency characteristic
    d. Monetary unit assumption

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

62. Which of the following is an implication of the going concern assumption?
    a. The historical cost principle is credible.
    b. Depreciation and amortization policies are justifiable and appropriate.
    c. The current-noncurrent classification of assets and liabilities is justifiable and signify-cant.
    d. All of these.

63. Proponents of historical cost ordinarily maintain that in comparison with all other valuation alternatives for general purpose financial reporting, statements prepared using historical costs are more
    a. reliable.
    b. relevant.
    c. indicative of the entity's purchasing power.
    d. conservative.

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

65. Revenue is generally recognized when realized or realizable and earned. This statement describes the
    a. consistency characteristic.
    b. matching principle.
    c. revenue recognition principle.
    d. relevance characteristic.

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

67. Revenue generally should be recognized
    a. at the end of production.
    b. at the time of cash collection.
    c. when realized.
    d. when realized or realizable and earned.

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

69. Under *Statement of Financial Accounting Concepts No. 5,* which of the following, in the most precise sense, means the process of converting noncash resources and rights into cash or claims to cash?
    a. Recognition
    b. Measurement
    c. Realization
    d. Allocation

70. "When products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash" is a definition of
    a. allocated.
    b. realized.
    c. realizable.
    d. earned.

71. The allowance for doubtful accounts, which appears as a deduction from accounts receivable on a balance sheet and which is based on an estimate of bad debts, is an application of the
    a. consistency characteristic.
    b. matching principle.
    c. materiality constraint.
    d. revenue recognition principle.

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

73. Which of the following serves as the justification for the periodic recording of depreciation expense?
    a. Association of efforts (expense) with accomplishments (revenue)
    b. Systematic and rational allocation of cost over the periods benefited
    c. Immediate recognition of an expense
    d. Minimization of income tax liability

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

75. Which of the following statements concerning the cost-benefit relationship is not true?
    a. Business reporting should exclude information outside of management's expertise.
    b. Management should not be required to report information that would significantly harm the company's competitive position.
    c. Management should not be required to provide forecasted financial information.
    d. If needed by financial statement users, management should gather information not included in the financial statements that would not otherwise be gathered for internal use.

76. Under *Statement of Financial Accounting Concepts No. 2,* which of the following relates to both relevance and reliability?
    a. Cost-benefit constraint
    b. Predictive value
    c. Verifiability
    d. Representational faithfulness

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

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

79. Which of the following are considered pervasive constraints by *Statement of Financial Accounting Concepts No. 2*?
    a. Cost-benefit relationship and conservatism
    b. Timeliness and feedback value
    c. Conservatism and verifiability
    d. Materiality and cost-benefit relationship

80. The basic accounting concept that refers to the tendency of accountants to resolve uncertainty in favor of understating assets and revenues and overstating liabilities and expenses is known as the
    a. conservatism constraint.
    b. materiality constraint.
    c. substance over form principle.
    d. industry practices constraint.

81. Which of the following best illustrates the accounting concept of conservatism?
    a. Use of the allowance method to recognize bad debt losses from credit sales
    b. Use of the lower of cost or market approach in valuing inventories.
    c. Use of the same accounting method from one period to the next in computing depreciation expense
    d. Utilization of a policy of deliberate understatement of asset values in order to present a conservative net income figure

82. Trade-offs between the characteristics that make information useful may be necessary or beneficial. Issuance of interim financial statements is an example of a trade-off between
    a. relevance and reliability.
    b. reliability and periodicity.
    c. timeliness and materiality.
    d. understandability and timeliness.

83. Allowing firms to estimate rather than physically count inventory at interim (quarterly) periods is an example of a trade-off between
    a. verifiability and reliability.
    b. reliability and comparability.
    c. timeliness and verifiability.
    d. neutrality and consistency.

[P]84. In matters of doubt and great uncertainty, accounting issues should be resolved by choosing the alternative that has the least favorable effect on net income, assets, and owners' equity. This guidance comes from the
    a. materiality constraint.
    b. industry practices constraint.
    c. conservatism constraint.
    d. full disclosure principle.

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	c	31.	c	41.	c	51.	d	61.	d	71.	b	81.	b
22.	d	32.	b	42.	d	52.	b	62.	d	72.	b	82.	a
23.	c	33.	b	43.	b	53.	a	63.	a	73.	b	83.	c
24.	d	34.	d	44.	b	54.	a	64.	d	74.	c	84.	c
25.	d	35.	c	45.	d	55.	c	65.	c	75.	d		
26.	a	36.	d	46.	d	56.	c	66.	d	76.	a		
27.	d	37.	b	47.	c	57.	d	67.	d	77.	c		
28.	a	38.	d	48.	c	58.	a	68.	d	78.	d		
29.	c	39.	c	49.	d	59.	b	69.	c	79.	d		
30.	a	40.	a	50.	b	60.	a	70.	b	80.	a		

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

42. a company changes its inventory method every few years in order to maximize reported income (other answers are possible).
45. comparability.
49. change in equity of an entity during a period from transactions and other events and circumstances from nonowner sources.
61. going concern assumption.
66. an exchange has taken place and the earnings process is virtually complete.

MULTIPLE CHOICE—CPA Adapted

85. According to the FASB's conceptual framework, predictive value is an ingredient of

	Relevance	Reliability
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

86. According to the FASB's conceptual framework, which of the following relates to both relevance and reliability?

	Consistency	Verifiability
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

87. The FASB's conceptual framework classifies gains and losses based on whether they are related to an entity's major ongoing or central operations. These gains or losses may be classified as

	Nonoperating	Operating
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

88. According to the FASB's conceptual framework, earnings
    a. is the same as comprehensive income.
    b. excludes certain gains and losses that are included in comprehensive income.
    c. includes certain gains and losses that are excluded from comprehensive income.
    d. includes certain losses that are excluded from comprehensive income.

89. According to the FASB's conceptual framework, comprehensive income includes which of the following?

	Operating Income	Investments by Owners
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

90. According to the FASB's conceptual framework, the calculation of comprehensive income includes which of the following?

	Income from Continuing Operations	Distributions to Owners
a.	No	No
b.	Yes	No
c.	Yes	Yes
d.	No	Yes

91. According to the FASB's conceptual framework, comprehensive income includes which of the following?

	Gross Margin	Operating Income
a.	No	Yes
b.	No	No
c.	Yes	No
d.	Yes	Yes

92. Under Statements of Financial Accounting Concepts, comprehensive income includes which of the following?

	Gains	Gross Margin
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

93. According to the FASB's conceptual framework, the process of reporting an item in the financial statements of an entity is
    a. recognition.
    b. realization.
    c. allocation.
    d. matching.

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
85.	a	87.	b	89.	a	91.	d	93.	a
86.	b	88.	b	90.	b	92.	d		

EXERCISES

Ex. 2-94—Examination of the conceptual framework.

At an FASB Concept Framework Symposium, a former member of the FASB discussed his views of a conceptual framework. Some excerpts:

Standard Setting in the Private Sector
A framework of concepts comprises ideas that coordinate to form the fabric of a system: they determine its bounds. In a system like financial reporting that serves a broad public purpose, the first plank in the framework identifies the public role. The decision of the public sector in the 1930s to look at the private sector for the principal thrust to standard setting was sound and extraordinarily enlightened.

The credence given financial reporting will determine whether the private sector's role in standard setting will grow or shrink. An operable conceptual framework will go a long way in providing the necessary level of credibility. Without an operable conceptual framework, continuation of standard setting by the private sector would stand in considerable jeopardy.

Essence of the Conceptual Framework
The conceptual formulation starts with the broad role of financial reporting in society. It:

- Identifies its unique competence, that is, its bounds.
- States the objectives of the reporting.
- Defines the things admissible to financial statements.
- Identifies the circumstances triggering admission and qualities to be met for admission to financial statements.
- Selects useful measurements of things admitted.
- Furnishes criteria for display.

Those are major pieces of the framework. There are others, of course. The various parts are in a hierarchy ranging from highly abstract to reasonably concrete. They lend guidance—they do not provide simple, no-think answers. They leave open a significant range for hard thinking and deliberation about reporting standards. They furnish the reference point for the thinking.

Instructions
1. What are the basic concepts of the conceptual framework?
2. What are your views about the success of the conceptual framework?

Solution 2-94

1. The basic components of the conceptual framework are:
   a. Objectives—present the goals and purposes of accounting.
   b. Qualitative characteristics—the characteristics that make accounting information useful.
   c. Elements—provide the definitions of the broad classifications of items found in financial statements.
   d. Operational guidelines (recognition and measurement concepts)—recommend concepts to guide decisions concerning the display and disclosure of information about income, cash flows, and financial position. The operational guidelines are composed of three parts:

Solution 2-94 (cont.)

(1) Basic assumptions.
(2) Accounting principles.
(3) Constraints.

2. In general, the success of the conceptual framework will be determined by its acceptance in practice. The acceptance in practice will be based in large part upon the FASB's solution of practical problems on a timely basis.

   It is a matter of opinion and yet to be seen whether or not the conceptual framework will bring about the following benefits.

   a. The FASB should be able to issue more useful and consistent standards in the future.
   b. New practice problems should be solved more rapidly by reference to an existing framework.
   c. Better understanding of and confidence in the financial reporting process by financial statement users should result.
   d. Enhanced comparability among companies' financial statements should result.

Ex. 2-95—Accounting concepts—identification.

State the accounting assumption, principle, information characteristic, or constraint that is most applicable in the following cases.

1. All payments less than $25 are expensed as incurred. (Do not use conservatism.)
2. The company employs the same inventory valuation method from period to period.
3. A patent is capitalized and amortized over the periods benefited.
4. Assuming that dollars today will buy as much as ten years ago.
5. Rent paid in advance is recorded as prepaid rent.
6. Financial statements are prepared each year.
7. All significant post-balance sheet events are reported.
8. Personal transactions of the proprietor are distinguished from business transactions.

Solution 2-95

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

Ex. 2-96—Accounting concepts—identification.

Presented below are a number of accounting procedures and practices in Sanchez Corp. For each of these items, list the assumption, principle, information characteristic, or modifying convention that is violated.

1. Because the company's income is low this year, a switch from accelerated depreciation to straight-line depreciation is made this year.
2. The president of Sanchez Corp. believes it is foolish to report financial information on a yearly basis. Instead, the president believes that financial information should be disclosed only when significant new information is available related to the company's operations.
3. Sanchez Corp. decides to establish a large loss and related liability this year because of the possibility that it may lose a pending patent infringement lawsuit. The possibility of loss is considered remote by its attorneys.
4. An officer of Sanchez Corp. purchased a new home computer for personal use with company money, charging miscellaneous expense.
5. A machine, that cost $40,000, is reported at its current market value of $45,000.

Solution 2-96

1. Consistency.
2. Periodicity.
3. Matching (also, conservatism).
4. Economic entity.
5. Historical cost (also, revenue recognition)*.

*Reporting the asset at FMV of $45,000 implies the following entry:

Machine	5,000	
Revenue		5,000

Ex. 2-97—Accounting concepts—matching.

Listed below are several information characteristics and accounting principles and assumptions. Match the letter of each with the appropriate phrase that states its application. (Items *a* through *k* may be used more than once or not at all.)

a. Economic entity assumption
b. Going concern assumption
c. Monetary unit assumption
d. Periodicity assumption
e. Historical cost principle
f. Revenue recognition principle
g. Matching principle
h. Full disclosure principle
i. Relevance characteristic
j. Reliability characteristic
k. Consistency characteristic

____ 1. Stable-dollar assumption (do not use historical cost principle).

____ 2. Earning process completed and realized or realizable.

____ 3. Presentation of error-free information with representational faithfulness.

____ 4. Yearly financial reports.

____ 5. Accruals and deferrals in adjusting and closing process. (Do not use going concern.)

Ex. 2-97 (cont.)

____ 6. Useful standard measuring unit for business transactions.
____ 7. Notes as part of necessary information to a fair presentation.
____ 8. Affairs of the business distinguished from those of its owners.
____ 9. Business enterprise assumed to have a long life.
____ 10. Valuing assets at amounts originally paid for them.
____ 11. Application of the same accounting principles as in the preceding year.
____ 12. Summarizing significant accounting policies.
____ 13. Presentation of timely information with predictive and feedback value.

Solution 2-97

1. c	4. d	7. h	10. e	13. i
2. f	5. g	8. a	11. k	
3. j	6. c	9. b	12. h	

Ex. 2-98—Accounting concepts—fill in the blanks.

Fill in the blanks below with the accounting principle, assumption, or related item that *best* completes the sentence.

1. __________________________ and _________________________ are the two primary qualities that make accounting information useful for decision making.

2. Information that helps users confirm or correct prior expectations has __________________ ____________________.

3. __________________________ enables users to identify the real similarities and differences in economic phenomena because the information has been measured and reported in a similar manner for different enterprises.

4. Some costs which give rise to future benefits cannot be directly associated with the revenues they generate. Such costs are allocated in a ___________________ and __________________ manner to the periods expected to benefit from the cost.

5. _________________________ would allow the expensing of all repair tools when purchased, even though they have an estimated life of 3 years.

6. The __________________________ characteristic requires that the same accounting method be used from one accounting period to the next, unless it becomes evident that an alternative method will bring about a better description of a firm's financial situation.

7. _____________________ guides accountants to select the accounting treatment that is least likely to overstate income and assets.

Ex. 2-98 (cont.)

8. Parenthetical balance sheet disclosure of the inventory method utilized by a particular company is an application of the ______________________ principle.

9. Corporations must prepare accounting reports at least yearly due to the _______________ assumption.

10. Recording and reporting inflows at the end of production is an allowable exception to the ________________ principle.

Solution 2-98

1. Relevance; reliability
2. feedback value
3. Comparability
4. rational; systematic
5. The materiality convention
6. consistency
7. Conservatism
8. full disclosure
9. periodicity
10. revenue recognition

Ex. 2-99—Basic assumptions.

Briefly explain the four basic assumptions that underlie financial accounting.

Solution 2-99

1. The economic entity assumption states that economic activity can be identified with a particular unit of accountability.
2. The going concern assumption assumes that a business enterprise will have a long life.
3. The monetary unit assumption means that money is the common denominator of economic activity and provides an appropriate basis for accounting measurement and analysis. In addition, the monetary unit remains reasonably stable.
4. The periodicity assumption implies that the economic activities of an enterprise can be divided into artificial time periods.

Ex. 2-100—Revenue recognition.

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

Solution 2-100

1. During production. The revenue is known (contract) or dependably estimable. Total costs are estimable or other means are available to estimate progress toward completion. Examples are long-term construction contracts and service-type transactions.

Solution 2-100 (cont.)

2. At completion. There are quoted prices. Units are interchangeable. There are no significant distribution costs. Unit costs are not determinable. Examples are precious metals or agricultural products.
3. At collection. There is no reasonable basis for estimating the degree of collectibility. Costs of collection, bad debts, and repossessions are not estimable. Examples are installment sales and cost recovery method.

Ex. 2-101—Historical cost principle.

Cost as a basis of accounting for assets has been severely criticized. What defense can you build for cost as the basis for financial accounting?

Solution 2-101

Cost is definite and verifiable and not a matter for conjecture or opinion. Once established, cost is fixed as long as the asset remains the property of the party that incurred the cost. Cost is based on fact; that is, it is the result of an arm's length transaction. Cost is also measurable or determinable. Over the years, accountants have found cost to be the most practical basis for record keeping. Financial statements prepared on a cost basis provide business enterprise information having a common, accepted basis from which each reader can make inferences, comparisons, and analyses.

Ex. 2-102—Matching concept.

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

Solution 2-102

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

  The revenue recognition principle is that revenue is recognized when it is realized and it is earned.

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

Solution 2-102 (cont.)

The matching principle is that expenses are matched with revenues. Expenses are matched three ways:

1. When there is an association with revenue, expenses are matched with revenues in the period the revenues are recognized.
2. When no association with revenue is evident, expenses are allocated on some systematic and rational basis.
3. When no association with revenue is evident and no future benefits are expected, expenses are recognized immediately.