**True/False Questions**

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

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

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

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Understand

AACSB: Reflective thinking

AICPA: FN Measurement

3. The FASB is currently the public-sector organization responsible for setting accounting standards in the United States.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

4. The FASB’s due process invites various interested parties to indicate their opinions about whether financial accounting standards should be changed.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

5. Accounting for stock-based compensation is an area in which the FASB has received little political interference.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

6. The Public Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) changed the entity responsible for setting auditing standards in the United States.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

7. A rules-based approach to standard-setting stresses professional judgment as opposed to following a list of rules.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

8. Under federal securities laws, the SEC has the authority to set accounting standards in the United States.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

9. The primary responsibility for properly applying GAAP when communicating with investors and creditors through financial statements lies with a firm's auditors.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

10. Auditors play an important role in the resource allocation process by adding credibility to financial statements.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

11. The purpose of the conceptual framework is to provide a structure and framework for a consistent set of GAAP.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-06

Topic Area: Conceptual framework―Purpose

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

12. In the United States the conceptual framework indicates GAAP when a more specific accounting standard does not apply.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-06

Topic Area: Conceptual framework―Purpose

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

13. Materiality can be affected by the dollar amount of an item, the nature of the item, or both.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

14. According to the FASB’s Statements of Financial Accounting Concepts, conservatism is a desired qualitative characteristic of accounting information.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

15. Equity is a residual amount representing the owner's interest in the assets of the business.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

16. Revenues are inflows or other enhancements of assets or settlements of liabilities from activities that constitute the entity's ongoing operations.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements s

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

17. Gains or losses result, respectively, from the disposition of business assets for greater than, or less than, their book values.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

18. Comprehensive income is another term for net income.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

19. The FASB’s conceptual framework lists relevance and timeliness as the two fundamental qualitative characteristics of decision-useful information.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

20. The monetary unit assumption requires that items in financial statements be measured in a particular monetary unit.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

21. The periodicity assumption requires that present value calculations take into account the number of compounding periods in each year.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

22. Determining fair value by calculating the present value of future cash flows is a level 1 type of input.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

23. The FASB’s framework for measuring fair value doesn’t change the situations in which fair value is used under current GAAP.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

24. The revenue/expense approach emphasizes determining the appropriate amounts of revenue and expense in each reporting period.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-10

Topic Area: Evolving GAAP

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

25. The asset/liability approach emphasizes matching to determine what assets and liabilities should be reflected on the balance sheet.

Answer: False

Level of Learning: 1 Easy

Learning Objective: 01-10

Topic Area: Evolving GAAP

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

26. In IFRS, the conceptual framework indicates appropriate accounting when a more specific accounting standard does not apply.

Answer: True

Level of Learning: 1 Easy

Learning Objective: 01-11

Topic Area: International Financial Reporting Standards―IFRS

Blooms: Remember

AACSB: Diversity

AICPA: BB Global

27. Political pressure never affects the IFRS standard-setting process.

Answer: False

Level of Learning: Easy

Learning Objective: 01-11

Topic Area: International Financial Reporting Standards―IFRS

Blooms: Remember

AACSB: Legal

AACSB: Diversity

AICPA: BB Global

**Multiple Choice Questions**

28. 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 stocks.

d. Mergers and acquisitions.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Resource management

29. Corporations issue their shares to the investing public in the:

|  |  |  |
| --- | --- | --- |
|  | Primary market | Secondary market |
| a. | Yes | Yes |
| b. | No | Yes |
| c. | Yes | No |
| d. | No | No |

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Resource management

30. The primary focus for financial accounting information is to provide information useful for:

|  |  |  |
| --- | --- | --- |
|  | Investing decisions | Credit decisions |
| a. | Yes | Yes |
| b. | Yes | No |
| c. | No | Yes |
| d. | No | No |

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Resource management

AICPA: FN Risk analysis

31. 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.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical thinking

32. 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.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

33. Which of the following groups is **not** among financial intermediaries?

a. Mutual fund managers.

b. Financial analysts.

c. CPAs.

d. Credit rating organizations.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

34. Which of the following was the first private-sector entity that set accounting standards in the United States?

a. Accounting Principles Board.

b. Committee on Accounting Procedure.

c. Financial Accounting Standards Board.

d. AICPA.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

35. 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 of stock 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 stocks and bonds to others.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-01

Topic Area: Environment of financial accounting and reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Resource management

AICPA: FN Risk analysis

36. Porite Company recognizes revenue in the period in which it records an asset for the related account receivable, rather than in the period in which the account receivable is collected in cash. Porite’s practice is an example of:

a. Cash basis accounting.

b. Accrual accounting.

c. The matching principle.

d. Economic entity.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Evaluate

AACSB: Analytical thinking

AICPA: FN Measurement

37. 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.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical thinking

AICPA: FN Measurement

38. In a recent annual report, Apple Computer reported the following in one of its disclosure notes: "Warranty Expense: The Company provides currently for the estimated cost for product warranties at the time the related revenue is recognized.” This note exemplifies Apple's use of:

a. Conservatism.

b. Matching.

c. Realization principle.

d. Economic entity.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Evaluate

AACSB: Analytical thinking

AICPA: BB Critical Thinking

39. GAAP is an abbreviation for:

a. Generally authorized accounting procedures.

b. Generally applied accounting procedures.

c. Generally accepted auditing practices.

d. Generally accepted accounting principles.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

40. The FASB issues accounting standards in the form of:

a. Accounting Research Bulletins.

b. Accounting Standards Updates.

c. Financial Accounting Standards.

d. Financial Technical Bulletins.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

41. Pronouncements issued by the Committee on Accounting Procedures:

a. Dealt with specific accounting and reporting problems.

b. Were based on exposure drafts and public comment letters.

c. Originated from congressional studies and SEC directives.

d. Were the outcome of research studies and a theoretical framework.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

42. The FASB's standard-setting process includes, in the correct order:

a. Exposure draft, research, discussion paper, Accounting Standards Update.

b. Research, exposure draft, discussion paper, Accounting Standards Update.

c. Research, discussion paper, exposure draft, Accounting Standards Update.

d. Discussion paper, research, exposure draft, Accounting Standards Update.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

43. Which of the following is **not** a provision of the Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley)? The Act:

a. Changed the entity responsible for setting auditing standards.

b. Increased corporate executive responsibility for financial statements.

c. Limited nonaudit services that can be performed by auditors for audit clients.

d. Changed the entity responsible for setting accounting standards.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

44. CPAs are licensed by:

a. The AICPA.

b. The SEC.

c. The federal government.

d. State governments.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

45. Which of the following has the statutory authority to set accounting standards in the United States?

a. FASB.

b. IRS.

c. SEC.

d. AICPA.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

46. When a registrant company submits its annual filing to the SEC, it uses:

a. Form 10-A.

b. Form 10-K.

c. Form 10-Q.

d. Form S-1.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

47. The most likely important flaw leading to the demise of the APB was the perceived lack of:

a. Confidence.

b. Competence.

c. Independence.

d. Importance.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

48. Accounting standard-setting has been characterized as:

a. A political process.

b. Using the scientific method.

c. Pure deductive reasoning.

d. Pure inductive reasoning.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

49. The International Accounting Standards Board:

a. Was the predecessor to the IASC.

b. Can overrule the FASB when their policies disagree.

c. Promotes the use of high-quality, understandable global accounting standards.

d. Has its headquarters in Geneva.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-03

Learning Objective: 01-11

Topic Area: Development of accounting and reporting standards

Topic Area: International Financial Reporting Standards―IFRS

Blooms: Remember

AACSB: Diversity

AICPA: BB Legal

AICPA: BB Global

50. Which of the following is **not** a provision of the Public Company Accounting Reform and Investor Protection Act of 2002?

a. Corporate executive accountability.

b. Auditor rotation.

c. Retention of work papers.

d. All of these answer choices are correct.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

51. The primary professional organization for those accountants working in industry is the:

a. AAA.

b. AICPA.

c. IIA.

d. IMA.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

52. In the Norwalk Agreement, the FASB and IASB pledged to:

a. Combine their organizations to form the BUSYB.

b. Make progress on specific MOU projects.

c. Achieve convergence by the year 2015.

d. Remove existing differences between their standards.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-03

Learning Objective: 01-11

Topic Area: Development of accounting and reporting standards

Topic Area: International Financial Reporting Standards―IFRS

Blooms: Remember

AACSB: Diversity

AICPA: BB Global

53. Which of the following is **not** a concern expressed by the SEC regarding IFRS adoption by the U.S.?

a. Need for the U.S. to have strong influence on the standard-setting process and ensure that standards meet U.S. needs.

b. The language barriers associated with cooperation among many countries in developing IFRS.

c. The high costs to companies of converting to IFRS.

d. The fact that many laws, regulations and private contracts reference U.S. GAAP.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Diversity

AICPA: BB Global

54. The most political issue in the FASB's most recent deliberations and amendments to GAAP on stock options was:

a. The negative effects on earnings of companies in the tech industry if they had to recognize expenses associated with stock compensation.

b. The negative effects on assets of recognizing stock options in equity.

c. The disclosure of stock compensation expense in the notes.

d. Accounting for stock options that have not yet been granted to employees.

Answer: a

Level of Learning: 3 Hard

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

55. An important historical reason for the FASB reversing its positions when political pressures occur is:

a. The cost of gathering data was prohibitive.

b. The difficulties in measurement were too great.

c. Companies withdraw financial support for the FASB.

d. The SEC did not support the FASB position.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

56. The most recent example of the political process at work in standard-setting is the heated debate that occurred on the issue of:

a. Pension plan accounting.

b. Accounting for postretirement benefits other than pensions.

c. Accounting for business combinations.

d. Accounting for fair values.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

57. Independent auditors express an opinion on the:

a. Fairness of financial statements.

b. Accuracy of financial statements.

c. Soundness of a company's future.

d. Quality of a company's management.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: FN Reporting

58. The possibility that the capital markets' focus on periodic profits may tempt a company's management to bend or even break accounting rules to inflate reported net income is an example of:

a. An ethical dilemma.

b. An accounting theory issue.

c. A technical accounting issue.

d. An auditor’s responsibility to inform the SEC.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Evaluate

AACSB: Analytical thinking

AACSB: Ethics

AICPA: BB Resource management

AICPA: FN Risk analysis

59. One of the elements that many believe distinguishes a profession from other occupations is the acceptance of responsibility by its members for the interests of those it serves, which is often articulated in:

a. Its conceptual framework.

b. Its code of ethics.

c. Federal laws.

d. State laws.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Ethics

AICPA: BB Critical Thinking

60. *SFAC 8* of the conceptual framework focuses on:

a. Objective and qualitative characteristics.

b. Presentation and disclosure.

c. Recognition and measurement.

d. Elements of financial statements.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-06

Topic Area: Conceptual framework―Purpose

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

61. The FASB's conceptual framework's qualitative characteristics of accounting information include:

a. Historical cost.

b. Realization.

c. Faithful representation.

d. Full disclosure.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

62. The FASB's conceptual framework's qualitative characteristics of accounting information include:

a. Full disclosure.

b. Relevance.

c. Going concern.

d. Historical cost.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

63. The conceptual framework's qualitative characteristic of relevance includes:

a. Predictive value.

b. Verifiability.

c. Completeness.

d. Neutrality.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

64. The conceptual framework's qualitative characteristic of faithful representation includes:

a. Predictive value.

b. Neutrality.

c. Confirmatory value.

d. Timeliness.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

65. *SFAC No.5* focuses on:

a. Objectives of financial reporting.

b. Qualitative characteristics of accounting information.

c. Recognition and measurement concepts in accounting.

d. Elements of financial statements.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-06

Topic Area: Conceptual framework―Purpose

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

66. The main issue in the debate over accounting for employee stock options was:

a. Which employees should receive options.

b. The amount of compensation expense that a company should recognize.

c. How many options should be granted to key executives.

d. The tax consequences of employee stock options.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

67. A firm's comprehensive income always:

a. Is the same as its net income.

b. Is greater than its net income.

c. Is less than its net income.

d. Could be greater than or less than net income.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

68. Net income equals:

a. Assets minus liabilities.

b. Revenues minus cost of goods sold.

c. Revenues minus expenses.

d. Cash receipts minus cash payments.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: FN Measurement

AICPA: FN Measurement

69. Enhancing qualitative characteristics of accounting information include each of the following except:

a. Timeliness.

b. Materiality.

c. Comparability.

d. Verifiability.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

70. The enhancing qualitative characteristic of understandability means that information should be understood by:

a. Those who are experts in the interpretation of financial information.

b. Those who have a reasonable understanding of business and economic activities.

c. Financial analysts.

d. CPAs.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

71. Fundamental qualitative characteristics of accounting information are:

a. Relevance and comparability.

b. Comparability and consistency.

c. Faithful representation and relevance.

d. Neutrality and consistency.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

72. Enhancing qualitative characteristics of accounting information include:

a. Relevance and comparability.

b. Comparability and timeliness.

c. Understandability and relevance.

d. Neutrality and consistency.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

73. 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 answer choices are correct.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

74. When there is agreement between a measure or description and the phenomenon it purports to represent, information possesses which characteristic?

a. Verifiability.

b. Predictive value.

c. Faithful representation.

d. Timeliness.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

75. Surefeet Corporation changed its inventory valuation method. Which characteristic is jeopardized by this change?

a. Comparability.

b. Representational faithfulness.

c. Consistency.

d. Feedback value.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

76. Elements of financial statements do not include:

a. Monetary unit.

b. Investments by owners.

c. Comprehensive income.

d. Losses.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

77. The primary objective of financial accounting information is to provide useful information to:

a. Management.

b. Capital providers.

c. Regulators.

d. Academicians.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

78. Of the following, the most important objective for financial reporting is to provide information useful for:

a. Making decisions.

b. Determining taxable income.

c. Providing accountability.

d. Increasing future profits.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

79. A constraint on qualitative characteristics of accounting information is:

a. Timeliness.

b. Going concern.

c. Neutrality.

d. Cost-effectiveness.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

80. According to the conceptual framework, verifiability implies:

a. Legal evidence.

b. Logic.

c. Consensus.

d. Legal verdict.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

81. Maltec Corporation has started placing its quarterly financial statements on its web page, thereby reducing by 10 days the time to get information to investors and creditors. The qualitative concept improved is:

a. Comparability.

b. Consistency.

c. Timeliness.

d. Faithful representation.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical thinking

82. Recognizing expected losses immediately, but deferring expected gains, is an example of:

a. Materiality.

b. Conservatism.

c. Cost-effectiveness.

d. Timeliness.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

83. Change in equity from nonowner sources is:

a. Comprehensive income.

b. Revenues.

c. Expenses.

d. Gains and losses.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

84. Which of the following Statements of Financial Accounting Concepts defines the 10 elements of financial statements?

a. *SFAC 4.*

b. *SFAC 3.*

c. *SFAC 5.*

d. *SFAC 6.*

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

85. 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.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Resource management

86. Mega Loan Company has very stringent credit requirements and, accordingly, has negligible losses from uncollectible accounts. The company's independent accountants did not protest when, contrary to GAAP, the company recorded bad debt expense only when specific accounts were determined to be uncollectible, rather than use an allowance for uncollectible accounts. The concept demonstrated is:

a. Comparability.

b. Faithful representation.

c. Cost-effectiveness.

d. Materiality.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

87. 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.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

88. An important argument in support of historical cost information is:

a. Relevance.

b. Predictive quality for future cash flows.

c. Materiality.

d. Verifiability.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

89. The conceptual framework's recognition and measurement concepts recognize which one of the following as an assumption?

a. Going concern.

b. Historical cost.

c. Full disclosure.

d. Realization.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

90. The assumption that in the absence of contrary information a business entity will continue indefinitely is the:

a. Periodicity assumption.

b. Entity assumption.

c. Going concern assumption.

d. Historical cost assumption.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

91. 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.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Create

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

92. Which of the following is typically characterized as a principle, rather than an assumption?

a. Periodicity.

b. Monetary unit.

c. Conservatism.

d. Full disclosure.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

93. Which of the following is **not** an identified valuation technique in GAAP regarding fair value measurement?

a. Cost approach.

b. Market approach.

c. Cost-benefit approach.

d. Income approach.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-09

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

94. 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.

Answer: c

Level of Learning: 1 Easy

Learning Objective: 01-09

Topic Area: Concepts―Qualitative characteristics

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

95. A cause-and-effect relationship is implicit in:

a. Realization.

b. Historical cost.

c. Matching.

d. The going concern assumption.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

96. The full disclosure principle requires a balance between:

a. Comparability and consistency.

b. Relevance and cost-effectiveness.

c. Reliability and neutrality.

d. Timeliness and predictive value.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

97. The recognition of which of the following expenses exemplifies the application of matching expenses with the revenues they produced?

a. President’s salary.

b. Research and development.

c. Cost of goods sold.

d. Advertising.

Answer: c

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

98. Land was acquired in 2018 for a future building site at a cost of $40,000. The assessed valuation for tax purposes is $27,000, a qualified appraiser placed its value at $48,000, and a recent firm offer for the land was for a cash payment of $46,000. The land should be reported in the financial statements at:

a. $40,000.

b. $27,000.

c. $46,000.

d. $48,000.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

99. Revenue should not be recognized until:

a. The seller has transferred goods or services to a customer.

b. Contracts have been signed and payment has been received.

c. Work has been performed and customer has been billed.

d. Collection has been made and warrantees have expired.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical thinking

AICPA: FN Measurement

100. Which of the following best demonstrates the full disclosure principle?

a. The multi-step income statement.

b. The auditors’ report.

c. The company's tax return.

d. Disclosure notes to financial statements.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Create

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

101. The matching principle is:

a. A valuation method.

b. An expense recognition accounting principle.

c. A cash basis reporting principle.

d. An asset classification procedure.

Answer: b

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

102. Which of the following best describes the additional information that companies use to meet the requirements of full disclosure in financial statements?

a. Parenthetical comments or modifying comments placed on the face of the financial statements.

b. Disclosure notes conveying additional insights about company operations, accounting principles, contractual agreements, and pending litigation.

c. Supplemental schedules and tables that report more detailed information than is shown in the primary financial statements.

d. Comments on the face of the financial statements, and schedules, tables, and narrative disclosures in notes to the financial statements.

Answer: d

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: FN Measurement

103. Ford Motor Company purchases services from suppliers on account and sells its products to distributors on short-term credit. As a result, do each of these events affect net income faster than they affect net operating cash flows?

|  |  |  |
| --- | --- | --- |
|  | Purchase Services | Sell Products |
| a. | Yes | Yes |
| b. | Yes | No |
| c. | No | Yes |
| d. | No | No |

Answer: a

Level of Learning: 3 Hard

Learning Objective: 01-02

Learning Objective: 01-09

Topic Area: Cash versus accrual accounting

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Analyze

AACSB: Analytical thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

104. The revenue/expense approach emphasizes:

a. Recognition of revenues.

b. Recognition of expenses.

c. The income statement.

d. All of the above are correct.

Answer: d

Level of Learning: 1 Easy

Learning Objective: 01-10

Topic Area: Evolving GAAP

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

105. The asset/liability approach emphasizes:

a. Whether amounts on the balance sheet meet the definitions of assets and liabilities.

b. A close relation between the balance sheet and the statement of cash flows.

c. The distinction between net assets and gross assets.

d. All of the above are correct.

Answer: a

Level of Learning: 1 Easy

Learning Objective: 01-10

Topic Area: Evolving GAAP

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

106. Under IFRS, the role of the conceptual framework:

a. Primarily involves guiding standard setters to make sure that standards are consistent with each other.

b. Includes serving as a guide for practitioners when a specific standard does not apply.

c. Is less important than in U.S. GAAP.

d. Has resulted primarily from a convergence with U.S. GAAP.

Answer: b

Level of Learning: 1 Easy

Learning Objective: 01-11

Topic Area: International Financial Reporting Standards―IFRS

Blooms: Remember

AACSB: Diversity

AICPA: BB Global

107. Under IFRS, the 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.

Answer: a

Level of Learning: 2 Medium

Learning Objective: 01-11

Topic Area: International Financial Reporting Standards―IFRS

Blooms: Remember

AACSB: Diversity

AICPA: BB Global

**Matching Pair Questions**

108. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Predictive value | Information is useful in projecting cash flows. | \_\_\_\_ |
| 2. Relevance | Pertinent to the decision at hand. | \_\_\_\_ |
| 3. Distribution to owners | Information is available prior to the decision. | \_\_\_\_ |
| 4. Confirmatory value | Decrease in equity due to transfers to owners. | \_\_\_\_ |
| 5. Timeliness | Information confirms expectations. | \_\_\_\_ |

Answer:

|  |  |  |  |
| --- | --- | --- | --- |
| **TERM** | **PHRASE** | | **Term number that matches the phrase.** |
|  |  |  | |
| 1. Predictive value | Information is useful in projecting cash flows. | **1** | |
| 2. Relevance | Pertinent to the decision at hand. | **2** | |
| 3. Distribution to owners | Information is available prior to the decision. | **5** | |
| 4. Confirmatory value | Decrease in equity due to transfers to owners. | **3** | |
| 5. Timeliness | Information confirms expectations. | **4** | |

Level of Learning: 2 Medium

Learning Objective: 01-06

Learning Objective: 01-07

Learning Objective: 01-08

Topic Area: Conceptual framework―Purpose

Topic Area: Concepts―Qualitative characteristics

Topic Area: Concepts―Elements of financial statements

Topic Area: GAAP―Underlying assumptions

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

109. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Gain | Along with relevance, a fundamental decision-specific quality. | \_\_\_\_ |
| 2. Materiality | Results if an asset is sold for more than book value. | \_\_\_\_ |
| 3. Completeness | Contains all information necessary for faithful representation. | \_\_\_\_ |
| 4. Comprehensive income | The change in equity from nonowner transactions. | \_\_\_\_ |
| 5. Faithful representation | Concerns the decision-making impact of both the amount and nature of an item. | \_\_\_\_ |

Answer:

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
|  |  |  |
| 1. Gain | Along with relevance, a fundamental decision-specific quality. | **5** |
| 2. Materiality | Results if an asset is sold for more than book value. | **1** |
| 3. Completeness | Contains all information necessary for faithful representation. | **3** |
| 4. Comprehensive income | The change in equity from nonowner transactions. | **4** |
| 5. Faithful representation | Concerns the decision-making impact of both the amount and nature of an item. | **2** |

Level of Learning: 2 Medium

Learning Objective: 01-06

Learning Objective: 01-07

Topic Area: Conceptual framework―Purpose

Topic Area: Concepts―Qualitative characteristics

Topic Area: Concepts―Elements of financial statements

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

110. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Neutrality | Important in analysis between firms. | \_\_\_\_ |
| 2. Comparability | Accounting information should be unbiased. | \_\_\_\_ |
| 3. Consistency | The decision to include an amount in the financial statements. | \_\_\_\_ |
| 4. Cost-effectiveness | Applying the same accounting practices over time. | \_\_\_\_ |
| 5. Recognition | Considers the value of using information relative to cost of providing it. | \_\_\_\_ |

Answer:

|  |  |  |  |
| --- | --- | --- | --- |
| **TERM** | **PHRASE** | | **Term number that matches the phrase.** |
|  |  |  | |
| 1. Neutrality | Important in analysis between firms. | **2** | |
| 2. Comparability | Accounting information should be unbiased. | **1** | |
| 3. Consistency | The decision to include an amount in the financial statements. | **5** | |
| 4. Cost-effectiveness | Applying the same accounting practices over time. | **3** | |
| 5. Recognition | Considers the value of using information relative to cost of providing it. | **4** | |

Level of Learning: 2 Medium

Learning Objective: 01-06

Learning Objective: 01-07

Learning Objective: 01-09

Topic Area: Conceptual framework―Purpose

Topic Area: Concepts―Qualitative characteristics

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

111. Listed below are five terms are followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Monetary unit assumption | Implies consensus among different observers. | \_\_\_\_ |
| 2. Verifiability | Assumes all transactions can be identified with a particular entity. | \_\_\_\_ |
| 3. Economic entity assumption | Assumes an entity will continue to operate indefinitely. | \_\_\_\_ |
| 4. Going concern assumption | Requires reporting the financial life of an entity in discrete time frames. | \_\_\_\_ |
| 5. Periodicity assumption | Ignores the possibility of inflation. | \_\_\_\_ |

Answer:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **TERM** | **PHRASE** | | **Term number that matches the phrase.** | |
|  |  |  | |
| 1. Monetary unit assumption | Implies consensus among different observers. | **2** | |
| 2. Verifiability | Assumes all transactions can be identified with a particular entity. | **3** | |
| 3. Economic entity assumption | Assumes an entity will continue to operate indefinitely. | **4** | |
| 4. Going concern assumption | Requires reporting the financial life of an entity in discrete time frames. | **5** | |
| 5. Periodicity assumption | Ignores the possibility of inflation. | **1** | |

Level of Learning: 2 Medium

Learning Objective: 01-07

Learning Objective: 01-08

Topic Area: Concepts―Qualitative characteristics

Topic Area: GAAP―Underlying assumptions

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

112. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Historical cost | Basis of measurement for fixed assets. | \_\_\_\_ |
| 2. Materiality | Discounts future cash flows. | \_\_\_\_ |
| 3. Revenue recognition | Occurs when goods or services are transferred to the customer. | \_\_\_\_ |
| 4. Full disclosure | Reporting of all information that could affect decisions. | \_\_\_\_ |
| 5. Present value | Application of GAAP sometimes avoided under this constraint. | \_\_\_\_ |

Answer:

|  |  |  |  |
| --- | --- | --- | --- |
| **TERM** | **PHRASE** | | **Term number that matches the phrase.** |
|  |  |  | |
| 1. Historical cost | Basis of measurement for fixed assets. | **1** | |
| 2. Materiality | Discounts future cash flows. | **5** | |
| 3. Revenue recognition | Occurs when goods or services are transferred to the customer. | **3** | |
| 4. Full disclosure | Reporting of all information that could affect decisions. | **4** | |
| 5. Present value | Application of GAAP sometimes avoided under this constraint. | **2** | |

Level of Learning: 2 Medium

Learning Objective: 01-06

Learning Objective: 01-07

Learning Objective: 01-09

Topic Area: Conceptual framework―Purpose

Topic Area: Concepts―Qualitative characteristics

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

113. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
|  |  |  |
| 1. Financial Accounting  Standards Board | Undermines representational faithfulness by being inconsistent with neutrality. | \_\_\_\_ |
| 2. Accounting Principles Board | It established GAAP before the FASB. | \_\_\_\_ |
| 3. Conservatism | Its *EITF Issues* are GAAP when entered in the Accounting Standards Codification. | \_\_\_\_ |
| 4. American Institute of CPAs (AICPA) | It has the authority to set U.S. accounting standards. | \_\_\_\_ |
| 5. Securities and Exchange  Commission | It is the national organization for CPAs in the United States. | \_\_\_\_ |

Answer:

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
|  |  |  |
| 1. Financial Accounting  Standards Board | Undermines representational faithfulness by being inconsistent with neutrality. | **3** |
| 2. Accounting Principles Board | It established GAAP before the FASB. | **2** |
| 3. Conservatism | Its *EITF Issues* are GAAP when entered in the Accounting Standards Codification. | **1** |
| 4. American Institute of CPAs (AICPA) | It has the authority to set U.S. accounting standards. | **5** |
| 5. Securities and Exchange  Commission | It is the national organization for CPAs in the United States. | **4** |

Level of Learning: 2 Medium

Learning Objective: 01-03

Learning Objective: 01-05

Learning Objective: 01-07

Topic Area: Development of accounting and reporting standards

Topic Area: Encouraging high-quality financial reporting

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: BB Legal

114. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Expenses | Net assets. | \_\_\_\_ |
| 2. Equity | Outflows of resources to generate revenues. | \_\_\_\_ |
| 3. Distributions to owners | Cash dividends. | \_\_\_\_ |
| 4. Investments by owners | Claims of creditors against the assets of a business. | \_\_\_\_ |
| 5. Liabilities | Transfers of resources in exchange for common and preferred stock. | \_\_\_\_ |

Answer:

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Expenses | Net assets. | **2** |
| 2. Equity | Outflows of resources to generate revenues. | **1** |
| 3. Distributions to owners | Cash dividends. | **3** |
| 4. Investments by owners | Claims of creditors against the assets of a business. | **5** |
| 5. Liabilities | Transfers of resources in exchange for common and preferred stock. | **4** |

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

115. Listed below are five terms followed by a list of phrases that describe or characterize each of the terms. Match each phrase with the correct number code for the term.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Losses | Net outflows from peripheral transactions. | \_\_\_\_ |
| 2. Assets | Increases in equity from the sale of goods and/or services. | \_\_\_\_ |
| 3. Revenues | Results if an asset is sold for more than book value. | \_\_\_\_ |
| 4. Comprehensive income | All changes in equity except owner transactions. | \_\_\_\_ |
| 5. Gains | Probable future economic benefits controlled by an entity. | \_\_\_\_ |

Answer:

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. Losses | Net outflows from peripheral transactions. | **1** |
| 2. Assets | Increases in equity from the sale of goods and/or services. | **3** |
| 3. Revenues | Results if an asset is sold for more than book value. | **5** |
| 4. Comprehensive income | All changes in equity except owner transactions. | **4** |
| 5. Gains | Probable future economic benefits controlled by an entity. | **2** |

Level of Learning: 1 Easy

Learning Objective: 01-07

Topic Area: Concepts―Elements of financial statements

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

116. Listed below are 10 organizations followed by a list of phrases that describe or characterize the organizations. Match each phrase with the correct organization by placing the number designating the best term in the space provided by the phrase.

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. SEC | Establishes auditing standards in the U.S for public companies. | \_\_\_\_ |
| 2. FASB | Primary national organization of accountants working in industry. | \_\_\_\_ |
| 3. IASB | Sets accounting standards in the United States. | \_\_\_\_ |
| 4. AICPA | Provides timely responses to financial reporting issues. | \_\_\_\_ |
| 5. EITF | The FASB's parent organization. | \_\_\_\_ |
| 6. PCAOB | Advises the FASB. | \_\_\_\_ |
| 7. IMA | FASB's predecessor. | \_\_\_\_ |
| 8. FASAC | Regulates the financial reporting for public companies. | \_\_\_\_ |
| 9. APB | National organization of certified public accountants. | \_\_\_\_ |
| 10. FAF | Sets global accounting standards. | \_\_\_\_ |

Answer:

|  |  |  |
| --- | --- | --- |
| **TERM** | **PHRASE** | **Term number that matches the phrase.** |
| 1. SEC | Establishes auditing standards in the U.S for public companies. | **6** |
| 2. FASB | Primary national organization of accountants working in industry. | **7** |
| 3. IASB | Sets accounting standards in the United States. | **2** |
| 4. AICPA | Provides timely responses to financial reporting issues. | **5** |
| 5. EITF | The FASB's parent organization. | **10** |
| 6. PCAOB | Advises the FASB. | **8** |
| 7. IMA | FASB's predecessor. | **9** |
| 8. FASAC | Regulates the financial reporting for public companies. | **1** |
| 9. APB | National organization of certified public accountants. | **4** |
| 10. FAF | Sets global accounting standards. | **3** |

Level of Learning: 2 Medium

Learning Objective: 01-03

Learning Objective: 01-05

Topic Area: Development of accounting and reporting standards

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: BB Legal

**Problems**

**Use the following to answer questions 117 and 118**:

Alpaca Corporation had revenues of $200,000 in its first year of operations. The company has not collected on $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 40%.

117. Compute net income for the first year for Alpaca Corporation.

**Answer:**

|  |  |  |
| --- | --- | --- |
| Revenues |  | $200,000 |
| Expenses: |  |  |
| Cost of goods sold | 70,000 |  |
| Salaries | 15,000 |  |
| Interest | 2,000 |  |
| Insurance | 3,000 | 90,000 |
| Income before tax |  | 110,000 |
| Income tax at 40% |  | 44,000 |
| Net income |  | $ 66,000 |
|  |  |  |

Level of Learning: 3 Hard

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

118. Compute the cash balance at the end of the first year for Alpaca Corporation.

**Answer:**

|  |  |  |
| --- | --- | --- |
| 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 |  | 44,000 |
| Total cash disbursements |  | 112,000 |
| Ending cash balance |  | $108,000 |
|  |  |  |

Level of Learning: 2 Medium

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

**Use the following to answer questions 119 and 120**:

Tri Fecta, a partnership, had revenues of $360,000 in its first year of operations. The partnership has not collected on $35,000 of its sales and still owes $40,000 on $150,000 of merchandise it purchased. There was no inventory on hand at the end of the year. The partnership paid $25,000 in salaries. The partners invested $40,000 in the business and $25,000 was borrowed on a five-year note. The partnership paid $3,000 in interest that was the amount owed for the year and paid $8,000 for a two-year insurance policy on the first day of business.

119. Compute net income for the first year for Tri Fecta.

**Answer:**

|  |  |  |
| --- | --- | --- |
| Revenues |  | $360,000 |
| Expenses: |  |  |
| Cost of Goods Sold | $150,000 |  |
| Salaries | 25,000 |  |
| Interest | 3,000 |  |
| Insurance | 4,000 | 182,000 |
| Net income |  | $178,000 |
|  |  |  |

Level of Learning: 3 Hard

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

120. Compute the cash balance at the end of the first year for Tri Fecta.

**Answer:**

|  |  |  |
| --- | --- | --- |
| Cash receipts: |  |  |
| Sales revenue | $360,000 |  |
| Less: Accounts receivable | 35,000 | $325,000 |
| Owners' investments |  | 40,000 |
| Note payable |  | 25,000 |
| Total receipts |  | 390,000 |
| Cash disbursements: |  |  |
| Purchases | 150,000 |  |
| Less: Accounts payable | 40,000 | 110,000 |
| Salaries paid |  | 25,000 |
| Interest paid |  | 3,000 |
| Insurance paid |  | 8,000 |
| Total cash disbursements |  | 146,000 |
| Ending cash balance |  | $244,000 |
|  |  |  |

Level of Learning: 2 Medium

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

**Use the following to answer questions 121–125**:

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 stockholders’ 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) |

121. Compute Amazon's balance in cash at the beginning of the year.

Answer:

Beginning balance in Cash + Net increase in Cash = Ending balance in Cash

Therefore, Beginning balance in Cash = Ending balance in Cash – Net increase in Cash

= $1,022 – 9 = $1,013

Level of Learning: 2 Medium

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

122. Compute Amazon's total liabilities at the end of the year.

Answer:

Total assets = Total liabilities + Total stockholders' equity

Therefore, Total liabilities = Total assets – Total stockholders' equity =

$4,363 –431 = $3,932

Level of Learning: 1 Easy

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

123. Compute Amazon’s cost of goods sold for the year.

Answer:

Gross profit = Net sales – Cost of goods sold

Therefore, Cost of goods sold = Net sales – Gross profit

= $10,711 – 2,456 = $8,255

Level of Learning: 1 Easy

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: Knowledge application

AICPA: BB Critical thinking

AICPA: FN Measurement

124. Compute the income before income tax for Amazon.

Answer:

Net income = Gross profit – Operating expenses + Other income (expense), net

= $2,456 – 2,067 + (12) = $377

Level of Learning: 1 Easy

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Apply

AACSB: AICPA: BB Critical thinking

AICPA: FN Measurement

125. Compare net income (loss) for the year to net cash flow from operating activities. Why are these amounts different? Briefly explain.

Answer:

These amounts are different because of the differences between cash and accrual accounting. As opposed to cash flows from operations, net income 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 often is recorded later than the cash payment to the supplier for the merchandise.

Level of Learning: 2 Medium

Learning Objective: 01-02

Topic Area: Cash versus accrual accounting

Blooms: Understand

AACSB: Reflective thinking

AACSB: Communication

AICPA: FN Measurement

126. 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 a patent 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 2018 fiscal year, Dower, Inc., received an order from a customer for $60,000. The merchandise will ship early in 2019. Because the sale was made to a long-time customer and the invoice was paid in 2018, the controller recorded the sale in 2018.
4. In the middle of its 2018 fiscal year, Sanguinetti, Inc. paid $12,000 to its insurance company for one-year comprehensive insurance coverage. Sanguinetti recorded the entire expenditure as an expense in 2018.
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.

Answers:

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 obligation to deliver goods.

4. Disagree. This is a violation of matching.

5. Agree. The company is conforming to the full disclosure principle.

6. Disagree. This is a violation of the periodicity assumption.

Level of Learning: 2 Medium

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Analyze

AACSB: Analytical thinking

AICPA: BB Critical thinking

AICPA: FN Measurement

**Essay**

The following answers point out the key phrases that should appear in students’ answers. They are not intended to be examples of complete student responses. It might be helpful to provide detailed instructions to students on how brief or in-depth you want their answers to be.

127. Identify or define the following terms: economic entity, going concern.

Answer:

Economic entity: All economic events can be identified with a particular economic entity.

Going concern: In the absence of information to the contrary, it is anticipated that a business entity will continue to operate indefinitely.

Level of Learning: 2 Medium

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

128. List the four financial statements most frequently provided to external users.

Answer:

Balance sheet, Income statement, Statement of cash flows, Statement of shareholders' equity.

Level of Learning: Easy

Learning Objective: 01-01

Topic Area: Cash versus accrual accounting

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

129. Explain and show an example of how the FASB's conceptual framework is needed in formulating standards on controversial topics.

Answer:

In order to provide consistency, a conceptual framework (a map clearly defining beliefs or structure) must be provided. This is the foundation for a strong, logical, and fair system. For example, in debating accounting for stock-based compensation, the FASB's conceptual framework explains the rationale for treating stock options as an expense. By relating the accounting for such compensation to the purpose of financial statements and their qualitative characteristics, the FASB can defend its positions without the bias inherent in such controversial issues.

Level of Learning: 3 Hard

Learning Objective: 01-06

Topic Area: Conceptual framework―Purpose

Blooms: Understand

AACSB: Communication

AICPA: BB Critical thinking

AICPA: BB Critical thinking

130. What is the SEC and how is it involved with accounting standard-setting?

Answer:

The Securities and Exchange Commission is a federal agency that has the authority to set accounting standards. However, the SEC has always relied on a private-sector body, such as the current FASB, to accomplish that task.

Level of Learning: 1 Easy

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Legal

131. What is the EITF and what is its purpose?

Answer:

The Emerging Issues Task Force (EITF) acts as a filter for the FASB. It includes 15 individuals from public accounting and private industry along with a representative from the FASB and an SEC observer. The task force focuses on emerging issues and attempts to reach a consensus, speeding up the standard-setting process.

Level of Learning: 2 Medium

Learning Objective: 01-03

Topic Area: Development of accounting and reporting standards

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

132. Accounting standard-setting has been characterized as a political process. Discuss this proposition giving an example.

Answer:

Changes in GAAP can have significant differential effects on companies, investors, creditors, and other interest groups. The FASB 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 GAAP. Accounting for stock-based compensations (options) and postretirement health care benefits are examples where accounting practices have been affected by political influences on GAAP.

Level of Learning: 2 Medium

Learning Objective: 01-04

Topic Area: GAAP―Standard-setting process

Blooms: Understand

AACSB: Communication

AICPA: BB Critical thinking

133. What are the key provisions of the Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act of 2002?

Answer:

The Act requires the regulation of auditors and the types of services they furnish to clients, increases accountability of corporate executives, addresses conflicts of interest for auditors and securities analysts, and requires that companies document and assess their internal controls. It also requires auditors to express an opinion on management’s assessment of internal controls, and the auditors must also express their own opinion on company internal controls.

Level of Learning: 2 Medium

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Communication

AICPA: BB Legal

134. What is the value of a company having financial statements audited by an independent auditor?

Answer:

Outside auditors add credibility to financial statements, increasing the confidence of capital market participants who rely on financial statements in making investment and credit decisions and recommendations.

Level of Learning: 2 Medium

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical thinking

135. What provisions did the Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act of 2002 make for performance of nonaudit services by an audit firm?

Answer:

The law makes it unlawful for the auditors of public companies to perform a variety of nonaudit services for audit clients. Prohibited services include bookkeeping, internal audit outsourcing, appraisal or valuation services, and various other consulting services. Other nonaudit services, including tax services, require preapproval by the audit committee of the company being audited.

Level of Learning: 2 Medium

Learning Objective: 01-05

Topic Area: Encouraging high-quality financial reporting

Blooms: Remember

AACSB: Ethics

AICPA: BB Legal

136. Briefly describe how materiality is featured in the conceptual framework.

Answer:

Materiality—Information is material if it can have an effect on a decision made by a user. Thus, materiality is an aspect of relevance. If an item is not material, GAAP need not be followed. For example, if a large corporation purchased a water cooler for one of its common areas for $120, the amount could be expensed rather than recorded as an asset even though the cooler will be useful for several years. Materiality is a judgment call. Materiality is concerned with both the dollar amount of an item and/or the nature of an item. It would probably be material if Microsoft received $1,000,000 in bribes from a Chinese company for its technology. A $1,000,000 write-off of old equipment would probably be immaterial for Microsoft.

Level of Learning: 3 Hard

Learning Objective: 01-07

Topic Area: Concepts―Qualitative characteristics

Blooms: Understand

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

137. Give an example of a violation of the stable monetary unit assumption. How would it affect the quality of financial statement information?

Answer:

If a country experiences severe inflation, this would violate the assumption that dollar amounts are constantly valued. This would limit the usefulness of adding numbers in financial statements, because (for instance) costs at different times are not comparable without adjusting for changes in purchasing power.

Level of Learning: 2 Medium

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions  
Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

138. Identify or define the following terms: periodicity, monetary unit.

Answer:

Periodicity—The life of a company can be divided into artificial periods to provide timely information to external users.

Monetary unit—In the United States, financial statement elements should be measured in terms of the U.S. dollar. It assumes that the value of a dollar is stable over time.

Level of Learning: 1 Easy

Learning Objective: 01-08

Topic Area: GAAP―Underlying assumptions  
Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

139. Identify or define the following term: historical cost.

Answer:

Historical cost—A measurement attribute under which asset and liability measurements are based on the amount given or received in an exchange transaction.

Level of Learning: 1 Easy

Learning Objective: 01-09   
Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

140. How does GAAP define fair value?

Answer:

Fair value is defined as the price that would be received to sell assets or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure  
Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

141. Over time, accounting standards have developed to reflect changes in the business world as well as changes in our ability to account for such changes. Using the example of marking assets and liabilities to their fair value, explain why you would expect accounting standards to change.

Answer:

Historically, financial accounting relied on transaction amounts (historical cost) as the fundamental measurement approach for reporting assets and liabilities. As markets have matured, it is more relevant and feasible to report some assets and liabilities at their fair values, particularly if such items have a ready market that is active.

Level of Learning: 2 Medium

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure

Blooms: Understand

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

142. List and briefly describe the five measurement attributes used commonly in current GAAP.

Answer:

a. Historical cost: the amount given or received in an exchange transaction.

b. Net realizable value: the amount of cash into which an asset is expected to be converted in the ordinary course of business.

c. Current cost: the cost that would be incurred to purchase or reproduce an asset.

d. Present value: the sum of future cash flows discounted for the time value of money.

e. Fair value: the price that would be received to sell assets or transfer liabilities in an orderly market transaction.

Level of Learning: 3 Hard

Learning Objective: 01-09

Topic Area: Concepts―Recognition–Measurement–Disclosure  
Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

143. List and briefly describe the three levels of inputs described in the fair-value measurement hierarchy.

Answer:

a. Quoted market prices in active markets for identical assets or liabilities.

b. Inputs other than quoted prices that can be observed for the asset or liability. These inputs include quoted prices for similar assets or liabilities in active or inactive markets and inputs that are derived principally from or corroborated by market data that can be observed.

c. Inputs that cannot be observed that reflect the entity’s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

Level of Learning: 3 Hard

Learning Objective: 01-09

Topic Area: Concepts―Qualitative characteristics  
Blooms: Remember

AACSB: Reflective thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

144. Contrast the asset/liability and revenue/expense approaches to accounting standard setting.

Answer:

Under the revenue/expense approach, we emphasize principles for recognizing revenues and expenses, with some assets and liabilities recognized as necessary to make the balance sheet reconcile with the income statement. Much of our accounting for revenues and expenses follows this revenue/expense approach.

Under the asset/liability approach, on the other hand, we first recognize and measure the assets and liabilities that exist at a balance sheet date and, secondly, recognize and measure the revenues, expenses, gains and losses needed to account for the changes in these assets and liabilities from the previous measurement date. Therefore, we should try to recognize and measure assets and liabilities appropriately, and as a result will also capture their inflows and outflows in a manner that provides relevant and representationally faithful information about revenues and expenses.

Level of Learning: 3 Hard

Learning Objective: 01-10

Topic Area: Evolving GAAP  
Blooms: Remember

AACSB: Communication

AICPA: BB Critical Thinking

AICPA: FN Measurement

145. Contrast the role of the conceptual framework in U.S. GAAP and IFRS.

Answer:

The conceptual frameworks in U.S. GAAP and IFRS are very similar and are converging even more with ongoing efforts by the FASB and IASB. However, in U.S. GAAP, the conceptual framework primarily provides guidance to standard setters to help them develop high-quality standards. In IFRS the conceptual framework guides standard setting, but in addition it is supposed to provide a basis for practitioners to make accounting judgments when another IFRS standard does not apply. Also, IFRS emphasizes the overarching concept of the financial statements providing a “true and fair representation” of the company. U.S. GAAP does not include a similar requirement, but U.S. auditing standards require this consideration.

Level of Learning: 3 Hard

Learning Objective: 01-11

Topic Area: International Financial Reporting Standards―IFRS  
Blooms: Remember

AACSB: Communication

AICPA: BB Critical Thinking