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QUESTIONS & ANSWERS

DEMO VERSION

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(LIMITED CONTENT)

Question: 1

According to the FASB conceptual framework, the objectives of financial reporting for business enterprises are based on:

- A. Generally accepted accounting principles.
- B. Reporting on management's stewardship.
- C. The need for conservatism.
- D. The needs of the users of the information.

Answer: D

Explanation:

Choice "d" is correct. The FASB conceptual framework states that the objectives of financial reporting stem from the informational needs of the external users of the information. SFAC 1 para. 28

Choice "a" is incorrect. Generally accepted accounting principles (GAAP) are derived from and based on the objectives of financial reporting, not the other way around.

Choice "b" is incorrect. Information concerning management's stewardship is only one aspect of the information financial statements are intended to provide. SFAC 1 para. 50

Choice "c" is incorrect. Conservatism is an underlying concept for financial accounting but is not the basis for the objectives. SFAC 2 para. 91-97

Question: 2

According to the FASB conceptual framework, the usefulness of providing information in financial statements is subject to the constraint of:

- A. Consistency.
- B. Cost-benefit.
- C. Reliability.
- D. Representational faithfulness.

Answer: B

Explanation:

Choice "b" is correct. The pervasive constraint on providing information in financial statements is that the cost should be outweighed by the benefit to be derived from providing the information. SFAC 1 para. 23, SFAC 2 para. 133

Choice "a" is incorrect. Consistency is an underlying concept for financial statements (and a secondary quality of accounting information), but it is not a constraint on providing information. SFAC 2 para. 120 Choice "c" is incorrect. Reliability is a primary quality of accounting information and an underlying concept for financial statements, but it is not a constraint on providing information. SFAC 2 para. 58 Choice "d" is incorrect. Representational faithfulness is an underlying concept for financial statements (as an element of reliability), but it is not a constraint on providing information. SFAC 2 para.

Question: 3

According to the FASB conceptual framework, which of the following attributes would not be used to measure inventory?

- A. Historical cost.
- B. Replacement cost.
- C. Net realizable value.
- D. Present value of future cash flows.

Answer: D

Explanation:

Choice "d" is correct. The present value of future cash flows is used to measure long-term receivables or payables, not inventory, because inventory is a short-term asset, which has more immediate cash flows. SFAC 5 para. 67

Choice "a" is incorrect. Historical cost can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory.

Choice "b" is incorrect. Replacement (or current) cost can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory.

Choice "c" is incorrect. Net realizable value can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory.

Question: 4

According to the FASB conceptual framework, which of the following situations violates the concept of reliability?

- A. Data on segments having the same expected risks and growth rates are reported to analysts estimating future profits.
- B. Financial statements are issued nine months late.
- C. Management reports to stockholders regularly refer to new projects undertaken, but the financial statements never report project results.
- D. Financial statements include property with a carrying amount increased to management's estimate of market value.

Answer: D

Explanation:

Choice "d" is correct. Management's estimate of market value lacks verifiability, which is a component of reliability. SFAC 2 para. 89

Choice "a" is incorrect. Communicating data on segments to analysts does not violate the concept of reliability.

Choice "b" is incorrect. Issuing financial statements nine months late violates timeliness, which is a component of relevance, not reliability. SFAC 2 para. 56

Choice "c" is incorrect. Neglecting to report results of new projects violates full disclosure, not reliability.

Question: 5

In the hierarchy of generally accepted accounting principles, APB Opinions have the same authority as AICPA:

- A. Statements of Position.
- B. Industry Audit and Accounting Guides.
- C. Issues Papers.
- D. Accounting Research Bulletins.

Answer: D

Explanation:

Choice "d" is correct. AICPA Accounting Research Bulletins, FASB Standards, FASB Interpretations, FASB Staff Positions, FASB Statement 133 Implementation Issues, and APB Opinions and Interpretations are the most authoritative sources of generally accepted accounting principles.

Choice "a" is incorrect. AICPA Statements of Position, AICPA Accounting and Auditing Guides, and FASB Technical Bulletins are secondary sources of generally accepted accounting principles.

Choice "b" is incorrect. AICPA Statements of Position, AICPA Accounting and Auditing Guides, and FASB Technical Bulletins are secondary sources of generally accepted accounting principles.

Choice "c" is incorrect. AICPA Issues Papers and Practice Bulletins, FASB Concepts Statements, and other authoritative pronouncements are tertiary sources for generally accepted accounting principles.

Question: 6

What is the underlying concept that supports the immediate recognition of a contingent loss?

- A. Substance over form.
- B. Consistency.
- C. Matching.
- D. Conservatism.

Answer: D

Explanation:

Choice "d" is correct. Conservatism is a prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered. Recognition of a contingent loss is the recording of an amount representing uncertainty and risk in a business situation. SFAC 2, SFAS 5 para. 82

Choice "a" is incorrect. The substance over form concept presumes that the transaction form may not dictate the accounting treatment.

Choice "b" is incorrect. Consistency is conformity from period to period with unchanging policies and procedures. SFAC 2

Choice "c" is incorrect. The matching principle dictates that expenses be matched with the related revenues generated or the time period in which the expense is incurred and known. SFAS #5 cites

matching as the one concept supporting the immediate recognition of a contingent loss, but it is not the primary underlying concept. SFAS 5 para. 76

Question: 7

According to the FASB conceptual framework, the process of reporting an item in the financial statements of an entity is:

- A. Allocation.
- B. Matching.
- C. Realization.
- D. Recognition.

Answer: D

Explanation:

Choice "d" is correct. Recognition is the process of recording an item in the financial statements of an entity. SFAC 5 para. 6

Choice "a" is incorrect. Allocation is the accounting process of assigning or distributing an amount according to a plan or a formula. SFAC 6 para. 142

Choice "b" is incorrect. Matching of costs and revenues is simultaneous or combined recognition of the revenues and expenses that result directly and jointly from the same transactions or other events. SFAC 6 para. 146

Choice "c" is incorrect. Realization is the process of converting noncash resources and rights into money. SFAC 6 para. 143

Question: 8

What are the Statements of Financial Accounting Concepts intended to establish?

- A. Generally accepted accounting principles in financial reporting by business enterprises.
- B. The meaning of "Present fairly in accordance with generally accepted accounting principles."
- C. The objectives and concepts for use in developing standards of financial accounting and reporting.
- D. The hierarchy of sources of generally accepted accounting principles.

Answer: C

Explanation:

Choice "c" is correct. Statements of Financial Accounting Concepts are intended to establish the objectives and concepts that the Financial Accounting Standards Board will use in developing standards of financial accounting and reporting. SFAC 1 para. 3

Choice "a" is incorrect. The Statements of Financial Accounting Concepts do not specify financial accounting standards prescribing accounting procedures or practices. SFAC 1 para. 3

Choice "b" is incorrect. Auditing standards develop the meaning of "Present fairly in accordance with generally accepted accounting principles."

Choice "d" is incorrect. The hierarchy of sources of generally accepted accounting principles is determined by GAAP.

Question: 9

During a period when an enterprise is under the direction of a particular management, its financial statements will directly provide information about:

- A. Both enterprise performance and management performance.
- B. Management performance but not directly provide information about enterprise performance.
- C. Enterprise performance but not directly provide information about management performance.
- D. Neither enterprise performance nor management performance.

Answer: C

Explanation:

Choice "c" is correct. Financial reporting, and especially financial statements, usually cannot and do not separate management performance from enterprise performance. Financial reporting provides information about an enterprise during a period when it was under the direction of a particular management but does not directly provide information about that management's performance. SFAC 1 para. 53

Question: 10

According to the FASB conceptual framework, which of the following statements conforms to the realization concept?

- A. Equipment depreciation was assigned to a production department and then to product unit costs.
- B. Depreciated equipment was sold in exchange for a note receivable.
- C. Cash was collected on accounts receivable.
- D. Product unit costs were assigned to cost of goods sold when the units were sold.

Answer: B

Explanation:

Choice "b" is correct. Revenues and gains are realized when assets are exchanged for cash or claims to cash. SFAC 5 para. 83.

Choice "a" is incorrect. Assigning depreciation in a production department is an example of allocating overhead. There is no realization associated with the assignment.

Choice "c" is incorrect. The realization concept is integral to accounting for revenues and expenses and is not connected to collection of receivables.

Choice "d" is incorrect. Assignment of overhead costs to products and thus to cost of goods sold is an example of matching. There is no realization associated with this assignment.

Question: 11

In Yew Co.'s 1992 annual report, Yew described its social awareness expenditures during the year as follows:

"The Company contributed \$250,000 in cash to youth and educational programs. The Company also

gave \$140,000 to health and human-service organizations, of which \$80,000 was contributed by employees through payroll deductions. In addition, consistent with the Company's commitment to the environment, the Company spent \$100,000 to redesign product packaging."

What amount of the above should be included in Yew's income statement as charitable contributions expense?

- A. \$310,000
- B. \$390,000
- C. \$410,000
- D. \$490,000

Answer: A

Explanation:

Choice "a" is correct. Charitable contributions include amounts the company gave to recognized charities. This includes:

Youth and education programs	\$ 250,000
Health (\$140,000 - \$80,000)	<u>60,000</u>
Total	<u>\$ 310,000</u>

Note: Of the \$140,000, employees gave \$80,000, and the company \$60,000. Redesigning packaging is not a contribution to a charity.

Choice "b" is incorrect. The company gave only \$60,000 of the \$140,000. Employees gave \$80,000.

Choice "c" is incorrect. Redesigning packaging is not a contribution to a charity.

Choice "d" is incorrect. The company gave only \$60,000 of the \$140,000. Employees gave \$80,000.

Redesigning packaging is not a contribution to a charity.

Question: 12

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

- A. Comparability.
- B. Feedback value.
- C. Verifiability.
- D. Timeliness.

Answer: A

Explanation:

Choice "a" is correct. Comparability and consistency are secondary qualities of both relevance and reliability. SFAC 2 para. 111-122

Choice "b" is incorrect. Feedback value is a key characteristic of relevance only.

Choice "c" is incorrect. Verifiability is a key characteristic of reliability only.

Choice "d" is incorrect. Timeliness is a key characteristic of relevance only.

Question: 13

Which of the following is true regarding the comparison of managerial to financial accounting?

- A. Managerial accounting is generally more precise.
- B. Managerial accounting has a past focus and financial accounting has a future focus.
- C. The emphasis on managerial accounting is relevance and the emphasis on financial accounting is timeliness.
- D. Managerial accounting need not follow generally accepted accounting principles (GAAP) while financial accounting must follow them.

Answer: D

Explanation:

Choice "d" is correct. Public companies must follow GAAP for (external) financial reporting purposes. GAAP need not be followed for (internal) managerial accounting purposes.

Choice "a" is incorrect. Financial accounting is generally more precise.

Choice "b" is incorrect. Managerial accounting has a future focus, while financial accounting focuses on reporting past results.

Choice "c" is incorrect. The emphasis of financial accounting is providing useful information to financial statement users (including the characteristic of relevance), while the emphasis of managerial accounting is providing timely information to management decision makers.

Question: 14

Which of the following is a generally accepted accounting principle that illustrates the practice of conservatism during a particular reporting period?

- A. Capitalization of research and development costs.
- B. Accrual of a contingency deemed to be reasonably possible.
- C. Reporting investments with appreciated market values at market value.
- D. Reporting inventory at the lower of cost or market value.

Answer: D

Explanation:

Choice "d" is correct. The rule of conservatism states that revenues and gains should be recognized when the earnings process is complete, but that expenses and losses should be expensed immediately.

Reporting inventory at the lower of cost or market requires the recording of a loss on inventory when market is lower than cost in the period the loss is sustained, rather than when the inventory is sold, consistent with the rule of conservatism.

Choice "a" is incorrect. Because the future benefits of R&D costs are questionable, these cost should be expensed immediately, consistent with the rule of conservatism and the matching principle.

Choice "b" is incorrect. The rule of conservatism only requires the accrual of "probable" losses. The accrual of a reasonably possible loss is not required and the accrual of any contingent gain, whether probable, reasonably possible, or remote, is prohibited.

Choice "c" is incorrect. The reporting of marketable securities with appreciated values at market

value requires the recording of a gain on the asset before the gain is realized. This contradicts the rule of conservatism, but is allowed because fair value is a more relevant measure of the value of marketable securities.

Question: 15

Arpco, Inc., a for-profit provider of healthcare services, recently purchased two smaller companies and is researching accounting issues arising from the two business combinations. Which of the following accounting pronouncements are the most authoritative?

- A. AICA Statements of Position.
- B. AICPA Industry and Audit Guides.
- C. FASB Statements of Financial Accounting Concepts.
- D. FASB Statements of Financial Accounting Standards.

Answer: D

Explanation:

Choice "d" is correct. Since Arpco is a for-profit provider of healthcare services, it is covered under normal GAAP. Thus, the most authoritative pronouncements are the FASB Statements of Financial Accounting Standards (SFAS).

Choice "a" is incorrect. AICPA Statements of Position are not the most authoritative pronouncement for almost anything (other than for some issues that only they cover). They are normally "merely" the opinion of the AICPA.

Choice "b" is incorrect. AICPA Industry and Audit Guides are not the most authoritative pronouncement for almost anything (other than for some issues that only they cover).

Choice "c" is incorrect. FASB Statements of Financial Accounting Concepts are not authoritative pronouncements except where they have been incorporated by reference into an SFAS. They are the basis on which SFAS can be constructed.



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