Conceptual Framework for Financial Reporting
BE2-7 Basic Assumption

- Economic entity, Going concern, Monetary unit, Periodicity

a) The economic activities of a company are divided into 12-month periods for the purpose of issuing annual reports.

b) Many companies do not adjust amounts in their financial statements for the effects of inflation.

c) A company reports current and noncurrent classifications on its balance sheet.

d) The economic activities of the company and its subsidiaries are merged for accounting and reporting purposes.
BE2-8 Basic Principles

- Measurement, Revenue Recognition, Expense Recognition, Full disclosure

a) A corporation reports revenue in its income statement when the performance obligation is satisfied instead of when cash is collected.

b) A corporation recognizes depreciation expense for a machine over the 2-year period during which that machine helps the company earn revenue.

c) A corporation reports information about pending lawsuits in the notes to its financial statements.

d) A corporation reports land on its balance sheet at the amount paid to acquire it, even though the estimated fair value is greater.
a) Quality of information that permits users to identify similarities in and differences between two sets of economic phenomena.

b) Having information available to users before it loses its capacity to influence decisions.

c) Information about an economic phenomenon that has value as an input to the processes used by capital providers to form their own expectations about the future.

d) Information that is capable of making a difference in the decisions of users in their capacity as capital providers.

e) Absence of bias intended to attain a predetermined result or to induce a particular behavior.

**BE2-1 (Qualitative Characteristics)**

1. Relevance
2. Faithful representation
3. Predictive value
4. Confirmatory value
5. Comparability
6. Completeness
7. Neutrality
8. Timeliness
BE2-2 (Qualitative Characteristics)

1. Timeliness
2. Completeness
3. Free from error
4. Understandability
5. Faithful representation
6. Relevance
7. Neutrality
8. Confirmatory value

a) Quality of information that assures users that information represents the economic phenomena that it purports to represent.

b) Information about an economic phenomenon that corrects past or present expectations based on previous evaluations.

c) The extent to which information is accurate in representing the economic substance of a transaction.

d) Includes all the information that is necessary for a faithful representation of the economic phenomena that it purports to represent.

e) Quality of information that allows users to comprehend its meaning.
BE2-4 Qualitative Characteristics

- Relevance, Faithful representation, Comparability, Verifiability, Timeliness, Understandability

a) Annual reports are audited by CPAs.
b) Two corporations both use the FIFO cost flow assumption.
c) A company has used straight-line depreciation since it began operations.
d) Quarterly reports are issued immediately after each quarter ends.
BE 2-6 Identification of Elements

a) Retained earnings
b) Sales
c) Additional paid-in capital
d) Inventory
e) Depreciation
f) Loss on sale of equipment
g) Interest payable
h) Dividends
i) Gain on sale of investment
j) Issuance of common stock
Presented below are the assumptions, principles, and constraints used in this chapter:

1. Economic entity assumption
2. Going concern assumption
3. Monetary unit assumption
4. Periodicity assumption
5. Measurement-Historical cost principle
6. Measurement-Fair value principle
7. Expense recognition principle
8. Full disclosure principle
9. Cost constraint
10. Revenue recognition principle

**Instructions**

*Identify by number the accounting assumption, principle, or constraint that describes each situation below. Do not use a letter more than once.*

a) Allocates expenses to revenues in the proper period.

b) Indicates that fair value changes subsequent to purchase are not recorded in the accounts. (Do not use revenue recognition principle.)

c) Ensures that all relevant financial information is reported.

d) Rationale why plant assets are not reported at liquidation value. (Do not use historical cost principle.)

e) Indicates that personal and business record keeping should be separately maintained.

f) Separates financial information into time periods for reporting purposes.

g) Assumes that the dollar is the “measuring stick” used to report on financial performance.
E2-7 (Assumptions, Principles, and Constraints) Presented below are a number of operational guidelines and practices that have developed over time.

1. Economic entity assumption
2. Going concern assumption
3. Monetary unit assumption
4. Periodicity assumption
5. Measurement (Historical cost) principle
6. Measurement (Fair value) principle
7. Full disclosure principle
8. Cost constraint
9. Materiality
10. Conservatism
11. Expense recognition principle
12. Revenue recognition principle

Instructions: Select the assumption, principle, or constraint that most appropriately justifies these procedures and practices. (Do not use qualitative characteristics.)
(a) Fair value changes are not recognized in the accounting records.
(b) Financial information is presented so that investors will not be misled.
(c) Intangibles are capitalized and amortized over periods benefited.
(d) Repair tools are expensed when purchased.
(e) Agricultural companies use fair value for purposes of valuing crops.
(f) Each enterprise is kept as a unit distinct from its owner or owners.
(g) All significant post-balance sheet events are reported.
(h) Revenue is recorded at point of sale.
E2-7 (Assumptions, Principles, and Constraints) Presented below are a number of operational guidelines and practices that have developed over time.

1. Economic entity assumption
2. Going concern assumption
3. Monetary unity assumption
4. Periodicity assumption
5. Measurement (Historical cost) principle
6. Measurement (Fair value) principle
7. Full disclosure principle
8. Cost constraint
9. Materiality
10. Conservatism
11. Expense recognition principle
12. Revenue recognition principle

(i) All important aspects of bond indentures are presented in financial statements.

(j) Rational for accrual accounting.

(k) The use of consolidated statements is justified.

(l) Reporting must be done at defined time intervals.

(m) An allowance for doubtful accounts is established.

(n) Goodwill is recorded only at time of purchase.

(o) A company charges its sales commission costs to expense.
CA2-4 (a): Describe the following characteristics

1. Relevance
2. Faithful representation
3. Understandability
4. Comparability
5. Consistency
CA2-4 (b): Give example where one of the characteristics may be sacrificed in return for a gain in the other.

1. Relevance and faithful representation

2. Relevance and consistency

3. Comparability and consistency

4. Relevance and understandability

(c) Criterion to evaluate tradeoffs: usefulness for decision-making
CA2-5 Crucial event(s) in Revenue Recognition

Discuss the propriety of timing the recognition of revenue from customers and advertising in the company’s accounts with:

a) The cash sale of the magazine subscription.

b) The publication of the magazine every month.

c) Both events, by recognizing a portion of the revenue with the cash sale of the magazine subscription and a portion of the revenue with the publication of the magazine every month.
Conceptual Framework for Financial Reporting

**Assumptions**
1. Economic entity
2. Going concern
3. Monetary unit
4. Periodicity

**Recognition, Measurement, and Disclosure Concepts**

**Principles**
1. Measurement
2. Revenue recognition
3. Expense recognition
4. Full disclosure

**Constraints**
1. Cost
2. Industry practice

**Qualitative Characteristics**
1. Fundamental qualities
   A. Relevance
      1. Predictive value
      2. Confirmatory value
      3. Materiality
   B. Faithful representation
      1. Completeness
      2. Neutrality
      3. Free from error
2. Enhancing qualities
   1. Comparability
   2. Verifiability
   3. Timeliness
   4. Understandability

**Elements**
1. Assets
2. Liabilities
3. Equity
4. Investment by owners
5. Distribution to owners
6. Comprehensive income
7. Revenues
8. Expenses
9. Gains
10. Losses

**Objective**
Provide information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in their capacity as capital providers.

First level: The "why"—purpose of accounting

Second level: Bridge between levels 1 and 3

Third level: The "how"—implementation
IFRS SELF-TEST QUESTION

Information in a company’s first IFRS statements must:

a. have a cost that does not exceed the benefits.

b. be transparent.

c. provide a suitable starting point.

d. All the above.
IFRS SELF-TEST QUESTION

When converting to IFRS, a company must:

a. recast previously issued financial statements in accordance with IFRS.

b. use GAAP in the reporting period but subsequently use IFRS.

c. prepare at least three years of comparative statements.

d. use GAAP in the transition year but IFRS in the reporting year.