

Chapter 2

Test Questions Bank

Multiple Choice Questions

1. General purpose financial reporting is directed at the information needs of
 - a. **Primary external users**
 - b. All potential external users
 - c. Primary internal users
 - d. All internal users
 - e. Government entities
2. Which of the following is a pervasive restraint on an entity's ability to provide useful information?
 - a. Legal restrictions
 - b. Management's desire to provide more information
 - c. **Cost**
 - d. Untrained personnel
3. Which of the following is not an enhancing qualitative characteristic of financial reporting?
 - a. Timeliness
 - b. Comparability
 - c. Verifiability
 - d. **Relevance**
4. Which of the following is not an aspect of relevant financial information?
 - a. Predictive value
 - b. **Neutrality**
 - c. Confirmatory value
 - d. Materiality
5. Financial information that is capable of affecting the decision making of financial statement users is considered
 - a. Relevant
 - b. Reliable
 - c. Comparable
 - d. **Faithfully Represented**
6. Using the same accounting treatment for the same item in different periods is an example of
 - a. Comparability
 - b. **Consistency**
 - c. Timeliness
 - d. Relevance

7. Which of the following is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized in the financial statements?
 - a. Calculation
 - b. Recognition
 - c. **Measurement**
 - d. Preparation
8. Entity A expects to receive \$5,000,000 in tax credits if it meets its emissions regulations in the upcoming year. Should this \$5,000,000 be recognized as an asset in the current year?
 - a. Yes
 - b. **No**
9. Entity A undergoes a transaction in the current period in which the assets of the entity increase by more than liabilities (causing an increase in equity). Should this be recognized as income?
 - a. **Yes**
 - b. No
10. Entity A undergoes a transaction in which one asset increases by the amount that another asset decreases. Should this be considered income?
 - a. Yes
 - b. **No**

True/False Questions

1. The *Conceptual Framework* is, technically, an IFRS. (*False*)
2. The principle of substance over form is no longer considered a separate component of faithful representation. (*True*)
3. If there is a conflict between a specific IFRS standard and the guidelines of the *Conceptual Framework*, the guidelines in the framework should take precedent over the specific IFRS standard. (*False*)
4. An important part of faithful representation is the principle of conservatism. (*False*)
5. The objective of financial reporting is the foundation of the *Conceptual Framework*. (*True*)
6. An entity that has no plans or need to liquidate its operations is considered to be able to operate as a going concern. (*True*)
7. “Free from error”, one the aspects of faithfully represented information, means that the financial information is perfectly accurate. (*False*)
8. Based on the definition of an expense, purchasing inventory should be considered an expense. (*False*)
9. Information that is used for resource allocation decisions should also be useful in measuring management performance. (*True*)
10. The *Conceptual Framework* regards losses and expenses as separate items. (*False*)

11. The revaluation of an asset that gives rise to equity and meets the definition of income is included in income under IFRS. (*False*)

Short Answer Questions

1. What is faithful representation?

Faithful representation is that the financial information of an entity effectively represents the economic substance of the economic phenomena, rather than merely the legal form.

2. What is materiality, and how does it relate to relevance?

Information is material if omitting it or misstating it could influence the decisions of the users of financial statements about a particular reporting entity. Materiality is an aspect of relevance because immaterial information does not affect users' decisions.

3. What is the overriding objective of general purpose financial reporting (according to the Framework)?

The overriding objective of general purpose financial reporting is to provide financial information that is useful to investors, lenders, and other creditors in making decisions about providing resources to the entity.

4. Explain why accrual accounting is an important aspect of using the financial statements to assess past and future performance?

Using accrual accounting, the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims are recognized in the periods in which those effects occur, and not in the period when the resulting cash receipts and payments occur. Thus, the true economic substance of different periods can be compared to assess true performance.

5. Entity A is a growing company. Because of unfavorable market conditions that have decreased the profit margins, has produced the financial statements with a slight leaning towards providing information that would increase funding from investors and creditors, omitting several unbecoming facts. Is the information faithfully represented? Why or why not?

No, the information is not faithfully represented. First, the financial reports lack neutrality: the reports have been produced with the goal that users will receive them favorably. Secondly, the financial reports lack completeness: the reports have left out several unpleasant facts to manipulate the perception of the company.