Solution Manual for Intermediate Accounting Volume 1 Canadian 7th Edition
Beechy Conrod Farrell and McLeod Dick 1259108015 9781259108013
Full link download

Solution Manual

https://testbankpack.com/p/solution-manual-for-intermediate-accounting-volume-1-canadian-7th-edition-beechy-conrod-farrell-and-mcleod-dick-1259108015-9781259108013/

Concept Review Solutions

Concept Review Solutions

CHAPTER 2: ACCOUNTING JUDGEMENTS

Page

1. The financial statement concepts comprise the general body of accounting principles (GAAP) and are used by:

    1. Management when they adopt certain accounting policies and make accounting estimates. In particular, preparers can use the concepts to assess whether transactions should be recorded, how they should be measured and how they should be reported in the financial statements.
    2. Auditors to assess whether an entity has exercised appropriate professional judgment in selecting its accounting policies and preparing its financial statements.
    3. Standard setters to ensure standards are developed on a consistent and coherent framework.

    As we will continue to emphasize through this text, accounting is full of estimates—virtually every amount on a company's financial statements is the result of multiple estimates.

2. General-purpose financial statements are those prepared for distribution to a wide, undefined public. As such, the statements have not been designed, and may not be suitable, for use in specific decisions.

3. In exercising ethical professional judgement, a professional accountant must take into account a variety of factors including, but not limited to, the following:

- The users of financial statements, and their specific decisions and informational needs.
- The motivations of managers.
- The organization's operations (e.g., type of ownership, sources of financing, nature of its operating cycle).
- Reporting constraints, if any.

Page

1. The separate entity assumption may not be valid for a small corporation with a single shareholder, as the shareholder may enter into various (non-arm's length) transactions with the corporation, thereby blurring entity definitions. While a corporation is legally a separate entity, the owner of a small corporation, having full control over the affairs of the corporation, may mix business and personal affairs by, for example, intermingling cash funds and interchanging business and personal assets. The owner may extend loans to the corporation that are, in substance, equity infusions. In recognition of this, a bank may require personal guarantees from the owner the corporation's debts.

2. The continuity assumption may not be valid in two instances. First, if the business is a limited life venture intended only to exist for a limited period of time. Second, when a business is in financial difficulty and is expected to be shut down and liquidated.

3. An alternative to the proprietary concept is the entity concept. The entity concept considers that the owners (shareholders) are but one of many participants in the enterprise and that the net value added by the enterprise is distributed to the various factors of production. Factors of production include the providers of capital and labour, and the government; the residual represents reinvestment in the enterprise (the entity).

4. In a country with triple digit annual inflation, the stable currency assumption is no longer valid. In particular, the nominal dollar capital maintenance assumption is not appropriate. In such countries a business is deemed to have earned a profit only if it has generated enough earnings to maintain the purchasing power of the owners' equity. Due to high inflation, capital assets and income measured in nominal dollars may materially misrepresent financial performance, as their purchasing power may be severely eroded from period to period.

Page

1. The concept of relevance is the most important qualitative characteristic of financial information. If the accounting information is to be of any use, it must be relevant for its intended use.

2. The criterion of understandability does not imply that all information must be reduced to the lowest common level or simplified so that the least sophisticated investor would understand it. Rather, it is presumed that users have a reasonable understanding of business and economic activities, as well as some understanding of accounting.

3. The enhancing qualities of accounting information are comparability (consistency and uniformity), verifiability (independent observers can measure an economic event and arrive at the same result), timeliness and understandability.

4. There are often trade-offs between different qualitative criteria, as a given qualitative criterion may be satisfied only at the expense of another. For example, while information may become more verifiable by delaying publication of the statements until all future events came to pass and uncertain facts were confirmed, such information, however, may be more relevant now, when the decision must be made.

Page

1. Realization is the process of converting an asset, liability, or commitment into a cash flow (transactional event). Recognition is the process of measuring and including an item in the financial statements (accounting event). Recognition may precede realization (e.g., in accrual accounting); however, once realization has occurred, recognition must occur because there has been a cash flow impact that cannot be ignored in the accounts.

2. Accrual accounting means that assets and liabilities are recognized in the period in which the rights and obligations pertaining to them are established. Interperiod allocation is the recognition as expenses of those amounts that were originally recognized as assets, or the recognition of income for an item previously recognized as a liability. Interperiod allocation follows accrual accounting, bringing into income (or expense) assets or liabilities recognized in the accrual accounting entry (in a previous period).

3. The three criteria that must be met to justify recognition of an item in the financial statements are:

1. It must meet the definition of an element.
2. It must have an appropriate basis of reliable measurement (measurability).
3. For assets and liabilities, realization must be probable (probability).

Page

1. An entry value is the price to be paid to acquire an asset. Exit value for an asset is the value that can be recovered when as asset is disposed of. Exit value or settlement value for a liability is the amount to be paid to pay off the liability.

2. The qualitative criteria of relevance and faithful representation underlie accounting standards use of fair value measurements for some assets and liabilities.

3. The three levels of fair value hierarchy are:

Level 1 - quoted prices in active markets for identical assets;

Level 2 - prices for similar assets or that can be derived from observable market data; and

Level 3 - values derived by indirect valuation techniques, and not verifiable by direct observation of market data.

4. Highest and best use - represents the valuation of an asset based on the its most advantageous use, in cases where the asset may have several uses.

Page

1. Three possible measurement bases for inventory are: historical cost, net realizable value or fair value.

2. Period costs are only indirectly related to specific revenue-generating activities. They do not lend themselves easily to matching to specific revenues. Therefore, the concept of matching is usually applied to period costs as a matching of costs to time, as opposed to a matching of costs to revenues. Therefore, period costs may be recognized as expenses in the period incurred.

3. No, full disclosure means that the financial statements should report all relevant information bearing on the economic affairs of a business enterprise. The aim of full disclosure is to provide external users with the accounting information they need to make informed investment and credit decisions. Full disclosure requires, among other things, that the chosen accounting policies be explained in the disclosure notes. Although the common expression is "full disclosure," perhaps a more realistic expression is "adequate disclosure." Obviously, not all information that may be relevant to a financial statement user can be disclosed. Instead, the objective is to disclose enough supplemental information to keep from misleading the users of the statements who are likely to be using the statements to predict cash flows or to evaluate the earnings ability of the company. A useful guide to deciding what to disclose is as follows:

- Disclose accounting policy choice information.
- Disclose further detail about recognized items that have been summarized or are unusual.
- Disclose items that have not been recognized because they have failed one of the recognition criteria but are still potentially relevant.
- Disclose information about future cash flow.
- Disclose alternate measurement bases.
- Disclose information to assist investors in calculating return on investment.

Memo

To Canco Ltd.

Subject: Accounting Policies - ASPE and IFRS impact the company and its reporting.

1. **Frame work**

Both ASPE and IFRS provide a frame work for the application of the more detailed accounting principles. The principles are identified in ASPE by subject and handbook section (specific recommendations) and in IFRS by subject and specific recommendations in the pronouncements (IAS – international accounting standard, IFRS – international financial reporting standard).

The exercise of judgment, subject to the principles outlined below, can and does have a significant impact on the recording and reporting function carried out by Canco to reflect the economic results of its operating activities.

ASPE principals are outlined at section 1000 – Financial Statement Concepts

IFRS principals are outlined in the Conceptual framework for financial reporting.

There are both **qualitative and quantitative characteristics** to be considered and applied to the recording of the company's transactions. Understanding what these characteristics are will facilitate the choices that must be made by the company and its management.

2. **Qualitative Characteristics**

IFRS refers to **the qualitative characteristics** that govern the recording and reporting process, the principal characteristics being

- Relevance
- Materiality
- Faithful representation and
- Application of fundamental characteristics

These characteristics influence how the entity will apply **recognition and measurement (quantitative measurements)** to the following key financial statement elements

- Assets
- Liabilities
- Revenues
- Expenses

ASPE at section 1000 defines these **qualitative characteristics** (excerpts) as follows:

Relevance is achieved through information that has predictive value or feedback value and by its timeliness.

Materiality is the term used to describe the significance of financial statement information to Decision makers. An item of information, or an aggregate of items, is material if it is probable That its omission or misstatement would influence or change a decision. Materiality is a matter of professional judgment in the particular circumstances.

Representational faithfulness is achieved when transactions and events affecting the entity are presented in financial statements in a manner that is in agreement with the actual underlying transactions and events. Thus, transactions and events are accounted for and presented in a manner that conveys their substance rather than necessarily their legal or other form.

These characteristics are applied to the recognition and measurement of the key financial statement elements being: assets, liabilities, revenues and expenses.

IFRS indicates that information must be both relevant and faithfully represented if it is to be useful.

3. Accounting Principles for Recording and Measurement (quantitative)

Bearing in mind the qualitative and quantitative characteristics noted above, Canco needs to implement accounting policies for the recording of Inventory and the recognition and recording of revenues.

ASPE provides the following guidance on the recognition of key financial element and the characteristics that are attached to each.

Assets are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained. They have three essential Characteristics:

(a) they embody a future benefit
(b) the entity can control access to the benefit; and
(c) the transaction or event giving rise to the benefit has already occurred.

Revenues are increases in economic resources, resulting from the ordinary activities of an entity. Revenues normally arise from the sale of goods or the rendering of services

Inventory, as it is created and as long as it remains the property of Canco, would constitute an economic resource of the company. Consequently it would be recorded as an asset and be reflected on the statement of financial position (balance sheet). At the point of a sale the inventory is no longer the asset of the company, it is replaced by another asset, cash or accounts receivable. The key measurement event is then the recognition of the sale. The accounting policy for Canco must address the point at which Canco would derecognize the

inventory asset, record the related cost of sales and recognize the sale. The issues surrounding the recognition of revenues will be examined in greater detail in Chapter 6.

The accounting policies of Canco should also address how the company will measure and record the inventory asset as it is created and then held until derecognized on the sale. There are a number of issues surrounding the recording and measurement of inventory that will be addressed in greater detail at chapter 8.

While there are some differences in the rules for ASPE and IFRS (these will be xplored in the subsequent chapters) regardless of the choice between ASPE and IFRS the objective of the financial reporting process is the same and the fundamental principles that need to be applied are, for the most part, very similar.

The application of those principals, regardless of the choice, will require judgment and that judgment will have a significant impact. In both cases the application of Judgment is a key component, while ASPE states this explicitly and IFRS implicitly, both require it.