

## Chapter 2: Conceptual Framework for Financial Reporting

### Questions

1. Which of the following parties is **not** considered a primary user of the financial statements?
  - a. Existing investors
  - b. Lenders
  - c. Other creditors
  - d. Potential investors
  - e. All of the above are considered primary users of the financial statements
2. Which of the following is **not** one of the characteristics necessary for information to be considered faithfully represented?
  - a. Complete
  - b. Neutral
  - c. Verifiable
  - d. Free from error
3. Information that contains all of the enhancing qualitative characteristics is considered useful as long as it also contains one of the fundamental qualitative characteristics.
4. The IASB places more authority on its current framework than the FASB places on its current framework.
5. Which of the following constraints did the Boards acknowledge in regards to useful information?
  - a. Time
  - b. Projections and estimates
  - c. Complexity
  - d. Cost

### Exercises

1. Using the definition of and three features of a reporting entity as described by the Boards, determine whether or not a reporting entity exists in each of the following scenarios.
  - a. Granny Entity manufactures rocking chairs and sells them at retail stores throughout the nation. Any scrap wood left from its manufacturing process is sold to Camping Entity as firewood. Granny Entity has been contacted by multiple potential investors, particularly Scrap Entity, who are interested in investing in the activity of selling the scrap wood. Granny Entity needs to determine if the process of selling scrap wood would be considered a reporting entity.
  - b. Manufacturing Entity makes bikes and sells them to retailers. Manufacturing Entity purchases tires for its bikes from Rubber Company. Rubber Entity's only customer is Manufacturing Entity. Rubber Entity needs to determine if its financial dependence on Manufacturing Entity prevents it from being a reporting entity.
  - c. Frame Entity manufactures custom frames that it sells to its online customers. The manufacturing process is divided into two sub-processes: cutting and assembling the wood into a frame and cutting the glass and preparing it for use in the frame. Frame Entity does not sell frames without glass or vice versa. Are the two sub-processes separate reporting entities?

2. In each of the following situations, decide whether the two criteria for recognition in the financial statements have been met.
  - a. Money Entity decides to buy lottery tickets. If they pick the winning ticket, they will receive \$10 million. Should Money Entity recognize an asset?
  - b. Because of the installation of an environmentally friendly manufacturing facility, the federal government is obligated to give \$1 million to Nolan Entity in the form of a grant. Should Nolan Entity recognize an asset?
  - c. Plin Entity has spent a lot of money on employee training programs that have led to increased productivity and have improved Plin Entity's bottom line. Should Plin Entity recognize an asset related to the well-trained employees?
  - d. Reedy Entity purchased inventory on credit. Should the payable be recognized as a liability?

### **Writing Assignment**

1. Write a summary of the current status of the *Conceptual Framework* Project. The summary should be no longer than three pages.
2. Access and review a copy of the SEC study: "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System." Write an example of a rules-based vs. principles-based accounting standard. Prepare a brief summary of the recommendations that the SEC proposed to improve the standard setting process in the U.S.