CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

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Basic Concepts

Definition and Background

The Conceptual Framework is a summary of the terms and concepts that underlie the preparation and presentation of financial statements. The Conceptual Framework is concerned with general purpose financial statements, including consolidated financial statements. Special purpose reports are outside the scope of the framework.

Underlying Theme

The underlying theme of the framework is decision usefulness or Usefulness of information in making economic decision.

Purposes

Basic Purpose: To serve as a guide in developing future PFRSs and as a guide in resolving accounting issues not directly addressed by existing PFRS.

Specific Purposes:

1. To assist FRSC (a) in developing future PFRSs and reviewing existing PFRSs. (b) in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of FS.

Preparers of FS in applying PFRSs.

Users of FS in interpreting the information in FS.

Auditors in forming an opinion as to whether the FS conforms with PFRS.

2. To provide information to those who are interested with the work of FRSC.

Authoritative Status of the Conceptual Framework

(a) The Conceptual Framework is not a Philippine Financial Reporting Standard (PFRS) and hence does not define standard for any particular measurement or disclosure issue. Thus, nothing in the Conceptual Framework overrides any specific Philippine Financial Reporting Standard.

(b) In case where there is a conflict, the requirements of the Philippine Financial Reporting Standards shall prevail over the Conceptual Framework.

(c) In the absence of a standard or an interpretation that specifically applies to a transaction, management shall consider the applicability of the Conceptual Framework in developing and applying an accounting policy that results in information that is relevant and reliable.

Underlying Assumptions

Accounting assumptions or accounting postulates are the basic notions or fundamental premises on which the accounting process is based.

<table>
<thead>
<tr>
<th>List of Underlying Assumptions</th>
<th>Stated Underlying Assumption?</th>
<th>Under the Old CF</th>
<th>Under the New CF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Going Concern Principle</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Accrual Principle</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Accounting / Economic Entity Concept</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Time Period Principle</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Monetary Unit Principle</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

a) Going Concern (Continuity Assumption)

Going concern assumption means that the accounting entity is viewed as continuing in operation indefinitely in the absence of evidence to the contrary. Going concern is the foundation of cost principle.

Examples of application of going concern principle:
- The current and non-current classification of assets and liabilities
- The accrual of income and expenses and prepayments and unearned income.
- Depreciation of PPE, amortization of intangible assets and etc.
b) **Accrual Principle**

Accrual principle addresses the recognition of income and expenses as against the cash basis principle. Under this principle, *income is recognized when earned rather than when received and expense is recognized when incurred rather than when paid.*

c) **Accounting Entity Concept**

Under this concept, the *entity is viewed separately from its owners.* Accordingly, the personal transactions of the owners among themselves or with other entities are not recorded in the entity’s accounting records.

d) **Time Period Principle**

According to the going concern principle, the operation of the business is viewed indefinitely. That was the foundation of the time period principle. Under this principle, *the life of the entity is divided into series of reporting periods.* An accounting period is usually 12 months and may either be a calendar year or a fiscal year.

e) **Monetary Unit Principle**

Under this principle, accounting information should be stated in a *common measurement basis* to be useful, which is in the Philippines it is peso. Also, this concept assumes that the *purchasing power of the peso is regarded as constant.*

**Scope of the Conceptual Framework**

**Chapter 1: Objective of Financial Reporting (The Foundation of the CF)**

**Users of financial information**

Users of financial information is classified into primary and other users. *Primary users* include potential and existing investors, lenders and other creditors. They are considered as primary users since they are the primary providers of resources to the entity. Other users include employees, customers, government and their agencies and public.

<table>
<thead>
<tr>
<th>User</th>
<th>Concern(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investors</td>
<td>(a) Risk and return of investment</td>
</tr>
<tr>
<td></td>
<td>(b) Ability to pay dividends</td>
</tr>
<tr>
<td>Lenders and other creditors</td>
<td>Liquidity and solvency</td>
</tr>
<tr>
<td>Employees</td>
<td>Stability and profitability</td>
</tr>
<tr>
<td>Customers</td>
<td>Continuity</td>
</tr>
<tr>
<td>Government</td>
<td>Regulatory</td>
</tr>
<tr>
<td>Public</td>
<td>Various</td>
</tr>
</tbody>
</table>

**Summary of users and their needs or concerns on the financial statements**

**Objectives of Financial Reporting**

*Overall objective: To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity*.

**Specific objectives**

A. To provide information useful in making decisions about providing resources to the entity.
B. To provide information useful in assessing the prospects of future net cash flows to the entity.
C. To provide information about entity resources, claims and changes in resources and claims.

**Limitations of financial reporting**

(a) General purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need.
(b) General purpose financial reports are not designed to show the value of an entity but they provide information to help the primary users estimate the value of the entity.
(c) General purpose financial reports are intended to provide common information to users and cannot accommodate every request for information.
(d) To a large extent, general purpose financial reports are based on estimate and judgment rather than exact depiction.

**Chapter 2: Qualitative Characteristics of Useful Information**

**Definition**

Qualitative characteristics are the qualities or attributes that make financial accounting information useful to the users.

Under the Conceptual Framework for Financial Reporting, qualitative characteristics are classified into fundamental qualitative characteristics and enhancing qualitative characteristics.
Fundamental Qualitative Characteristics

- are the qualities that make the information useful to the users in making economic decisions. These characteristics address the content or substance of information. The fundamental qualitative characteristics are relevance and faithful representation.

Relevance means the capacity of information to make a difference in a decision made by users. Relevant information has the following ingredients:

a) Predictive Value – the information can help users increase the likelihood of correctly predicting or forecasting outcome of events.

b) Confirmatory Value – the information enables users confirm or correct earlier expectations.

TAKE NOTE:

1) Predictive and confirmatory values are interrelated, meaning, often, information has both predictive and confirmatory values.
2) Materiality is NOT an ingredient of relevance but rather an specific aspect of relevance. Meaning, all material items are relevant but not all relevant items are material.
3) What is materiality?

Accordingly, the framework and PFRSs do not specify a uniform quantitative threshold for materiality, thus, materiality is purely based on judgment. In the exercise of judgment in determining materiality, the following factors may be considered: (a) Relative size of the item in relation to the total of the group to which the item belongs; (b) Nature of the item.

Faithful representation means that the information provides a true, correct and complete depiction of the economic phenomena that it purports to represent. Simply stated, faithful representation means that the descriptions and figures match what really existed or happened. Also, faithful representation means that the actual effects of the transactions shall be properly accounted for and reported in the financial statements. To be a perfectly faithful representation, a depiction should have three ingredients, namely:

a) Completeness – all information necessary for users to understand the phenomena depicted is provided, whether in words or in numbers.
b) Neutrality - means that the financial statements should not be prepared so as to favour one party to the detriment of another party. A neutral depiction is “without bias” in the selection or presentation of financial information.
c) Free from error - in this context, free from error does not mean perfectly accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process.

TAKE NOTE:

1) Substance over form and conservatism are not ingredients of faithful representation and are specific aspect only.
2) If there is a conflict between substance and form, the economic substance of the transaction shall prevail over the legal form. Examples of situation where substance over form is applied: (a) accounting for non-interest bearing notes receivable/payable; (b) finance lease accounting.
3) The Conceptual Framework did not include conservatism or prudence as an aspect of faithful representation because to do so would be inconsistent with neutrality. Under conservatism, when alternatives exist, the alternative which has the least effect on equity shall be chosen.

Enhancing Qualitative Characteristics

- are the qualities of information that enhances its usefulness. These characteristics address the form or presentation of information. The enhancing qualitative characteristics are verifiability, comparability, understandability and timeliness.

Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.

Information is comparable if it helps users identify similarities and differences between different sets of information that are provided by:

a) a single entity but different periods (intra-comparability); or
b) different entities in a single period (inter-comparability).

Although related, consistency and comparability are not the same. Comparability is the goal while consistency is the means of achieving the goal.

Understandability requires that financial information must be comprehensible or intelligible if it is to be useful but complex matters cannot be eliminated. Because of this, the framework requires the users to have a reasonable knowledge of business and economic activities and must review and analyze the information diligently.

Timeliness means having information available to decision makers in time to influence their decisions. In other words, timeliness requires that financial information must be available or communicated early enough when a decision is to be made. Relevant information may lose its relevance if there is undue delay in its reporting.
The cost constraint

Cost is a pervasive constraint on the information that can be provided by financial reporting. In other words, the cost constraint is a consideration of the cost incurred in generating financial information against the benefit to be obtained from having the information. The benefit derived from the information should exceed the cost incurred in obtaining the information.

Chapter 3: The Financial Statements and The Reporting Entity

Objective and Scope of Financial Statements

The objective of general purpose financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful in assessing:

a) The entity's prospects for future net cash inflows and
b) Management's stewardship over economic resources.

That information is provided in the:

1) Statement of Financial Position (for recognized assets, liabilities and equity)
2) Statement(s) of Financial Performance (for income and expenses)
3) Other Statements and Notes

Reporting Period of Financial Statements

Financial statements are prepared for a specified period of time or the reporting period. Financial statements also provide comparative information for at least ONE PRECEDING REPORTING PERIOD.

Reporting Entity

Reporting entity is an entity who must or chooses to prepare the financial statements and is NOT necessarily a legal entity.

As a result, we have a few types of financial statements:

a) Consolidated – a parent and subsidiaries report as a single reporting entity.
b) Unconsolidated or Individual – a parent alone provides reports.
c) Combined – reporting entity comprises two or more entities not linked by parent-subsidiary relationship

Chapter 4: Elements of Financial Statements

The elements of financial statements refer to the quantitative information shown in the statement of financial position and statement of comprehensive income, namely: Assets, Liabilities, Equity, Income and Expense. These elements are classified into:

<table>
<thead>
<tr>
<th>Elements directly related to Entity's</th>
<th>Financial Position</th>
<th>Financial Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset</td>
<td></td>
<td>Income</td>
</tr>
<tr>
<td>Liability</td>
<td></td>
<td>Expense</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Assets – a present economic resource controlled by the entity as a result of a past event. An economic resource is a right that has the potential to produce economic benefits.

The essential characteristics of an asset are:

a) The asset is controlled by the entity.
b) The asset is the result of a past transaction or event.
c) The asset provides future economic benefits.
d) The cost of the asset can be measured reliably.

NOTE: Tangibility and ownership are not essential characteristics of assets. Also, the presence or absence of expenditure is not necessary in determining the existence of assets.

Liability – is a present obligation of an entity arising from past transaction or event, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

The essential characteristics of a liability are:

a) The liability is the present obligation of a particular entity.
b) The liability arises from past transaction or event.
c) The settlement of the liability requires an outflow of resources embodying economic benefits.

NOTE: Identification of payee and certainty of timing of settlement and amount of liability are not essential characteristics of liabilities.

Equity - is the residual interest in the assets of the entity after deducting all of its liabilities.

Income – is the increase in economic benefit during the accounting period in the form of an inflow or increase of asset or decrease of liability that results in increase in equity, other than contribution from equity participants. Simply stated, income is an inflow of future economic benefit that increases equity, other than contribution by owners.

NOTE: Income encompasses both revenue and gains.
### REVENUE VS. GAIN

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Arises from</td>
<td>Incidental or peripheral operations</td>
</tr>
<tr>
<td>Ordinary course of business</td>
<td>At gross amount</td>
</tr>
<tr>
<td>(b) Presentation in the FS</td>
<td>At net amount (net of direct cost)</td>
</tr>
</tbody>
</table>

Comprehensive income is classified into two: Profit or Loss (P/L) or Other Comprehensive Income (OCI).

**General rule** is, an income is part of profit or loss unless it will be classified as OCI which are as follows:

1. Unrealized gain or loss on financial asset measured at fair value through other comprehensive income
2. Gain or loss from translating the financial statements of a foreign operation
3. Revaluation surplus during the year
4. Unrealized gain or loss from derivative contracts designated as cash flow hedge
5. Remeasurements of defined benefit plan including actuarial gain or loss on defined benefit obligation

**Expense** – is the decrease in economic benefit during the accounting period in the form of outflow or decrease in asset and increase in liability that results in decrease in equity, other than distribution to equity participants.

### Chapter 5: Recognition and Derecognition

**Recognition** is a term which means the *process of reporting* an asset, liability, income or expense on the face of the financial statements of an entity.

**Recognition criteria:**

- It meets the definition of an asset, liability, equity or expense and
- Recognizing it would provide useful information

The recognition of an item may not provide useful information if:

- It is uncertain whether an asset or liability exists
- An asset or liability exists but the probability of an inflow or outflow of economic benefits is low.

**NOTE:**

- The recognition criteria above apply to assets, liabilities, income and expense. There is no Equity Recognition Principle / Criteria because it is a residual interest.
- The expense recognition principle is the application of the matching principle. Accordingly, the matching principle requires that those costs and expenses incurred in earning a revenue should be reported in the same period.
- Expenses are incurred in conformity with the three applications of the matching principle, namely:
  - c.1) Cause and effect association - the cause and effect association principle means that "the expense is recognized when the revenue is already recognized" on the basis of a presumed direct association of the expense with specific revenue. This is actually the "strict matching concept". Examples: Cost of sales, warranty expense, sales commissions.
  - c.2) Systematic and rational allocation - Under the systematic and rational allocation principle, some costs are expensed by simply allocating them over the periods benefited. Example: Depreciation of PPE, amortization of intangible assets and depletion of wasting assets.
  - c.3) Immediate recognition - Under immediate recognition principle, the cost incurred is expensed outright because of uncertainty of future economic benefits or difficulty of reliably associating certain costs with future revenue. Examples: officers' salaries and most administrative expenses, casualty losses.

**Derecognition** is the OPPOSITE of recognition. It is the removal of a previously recognized asset or liability from the entity's financial statement position.

Derecognition occurs when the item no longer meet the definition of an asset or liability, such as when the entity control of all or part of the asset or no longer has a present obligation for all or part of the liability.

On derecognition, the entity:

- derecognizes the assets or liabilities that have expired or have been consumed, collected, fulfilled or transferred and recognized any resulting income and expenses.
- continues to recognize any assets or liabilities retained after the derecognition.

**NOTE:** Derecognition is NOT appropriate if the entity retains substantial control of a transferred asset.

### Chapter 6: Measurement

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the statement of financial position and income statement.

The Framework acknowledges that a variety of measurement bases are used today to different degrees and in varying combinations in financial statements including:
**Historical cost** – This measurement is based on the transaction price at the time of recognition of the element. The historical cost of an asset is the consideration paid to acquire the asset plus transaction costs. The historical cost of a liability is the consideration received to incur the liability minus transaction costs.

**Current value** – It measures the element updated to reflect the conditions at the measurement date. Current value measurement bases include the following:

1. **Fair Value** – is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value is not an entity specific measurement.

2. **Value in use** is the present value of the cash flows or other economic benefits, that an entity expects to derive from the use of an asset and from its ultimate disposal. **Fulfilment value** is the present value of the cash or other economic resources that an entity expects to be obliged to transfer as it fulfils a liability.

NOTE: Value in use and fulfilment value DO NOT include transaction costs in acquiring an asset or incurring the liability but include transactions costs expected to be incurred on the ultimate disposal of the asset or fulfilment of the liability.

3. **Current cost of an asset** is the cost of an equivalent asset at the measurement date, comprising the consideration that would be paid at the measurement date plus transaction costs that would be incurred on that date. Current cost of liability is the consideration that would be received for an equivalent liability at the measurement date minus transaction costs that would be incurred on that date.

NOTE: Current cost and historical cost are ENTRY VALUES while value in use, fulfilment value and fair value are EXIT VALUES.

The framework points out that it can be appropriate to measure some components of equity directly but it is not possible to measure total equity directly.

**Chapter 7: Presentation and Disclosure**

Information about assets, liabilities, equity, income and expenses is communicated through presentation and disclosure in the financial statements.

Effective communication makes information more useful. Effective communication requires:

1. Focusing on presentation and disclosure objectives and principles rather than on rules.
2. Classifying information by grouping similar items and separating dissimilar items.
3. Aggregating information in a manner that it is not obscured either by excessive detail or by excessive summarization.

NOTE: Classification refers to the sorting of assets, liabilities, equity, income or expenses with similar nature, function and measurement basis for presentation and disclosure purposes. Aggregation is the adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification.

**Chapter 8: Concepts of Capital and Capital Maintenance**

<table>
<thead>
<tr>
<th></th>
<th>Financial Capital</th>
<th>Physical Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concept of capital</td>
<td>Invested money or invested purchasing power</td>
<td>Productive capacity of the entity</td>
</tr>
<tr>
<td>Adopted by most entities?</td>
<td>✔</td>
<td>x</td>
</tr>
<tr>
<td>Measurement</td>
<td>Historical cost</td>
<td>Current cost</td>
</tr>
</tbody>
</table>

The "capital maintenance approach" or net assets approach means that net income occurs only after the capital used from the beginning of the period is maintained.

Under the financial capital concept, net income occurs "when the financial or nominal amount of the net assets at the end of the year exceeds the financial or nominal amount of the net assets at the beginning of the period, after excluding distributions to and contributions by owners during the period."

Under the physical capital concept, net income occurs "when the physical productive capital of the entity at the end of the year exceeds the physical productive capital at the beginning of the period, also after excluding distributions to and contributions from owners during the period."

Most of the problem solving questions regarding capital maintenance approach is based on financial capital. With such, the template below might be of help in answering.

| Net changes in equity | xxx |
| Less: Additional investment by owners | (xxx) |
| Add: Withdrawals and distributions to owners | xxx |
| **Comprehensive income** | xxx |
| Less: Other comprehensive income | (xxx) |
| Add: Other comprehensive loss | xxx |
| **Profit or Loss / Net Income** | xxx |
Reminders in using the template:
a) Please be mindful of the requirement of the problem. Profit or loss is different from comprehensive income.
b) The computation of net changes in equity depends on the given information. If the given information is already the beginning and ending balance of equity then it is easy to solve. But if the given information are the changes on the assets and liabilities then you have to evaluate each line item’s impact on equity. In evaluating the impact on the equity remember that: (1) Asset is directly related to equity while (2) liability is inversely related to equity.

<table>
<thead>
<tr>
<th>Summary of Effects on Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Item</strong></td>
</tr>
<tr>
<td>Asset:</td>
</tr>
<tr>
<td>Increase</td>
</tr>
<tr>
<td>Decrease</td>
</tr>
<tr>
<td>Contra-asset:</td>
</tr>
<tr>
<td>Increase</td>
</tr>
<tr>
<td>Decrease</td>
</tr>
<tr>
<td>Liability:</td>
</tr>
<tr>
<td>Increase</td>
</tr>
<tr>
<td>Decrease</td>
</tr>
<tr>
<td>Contra-liability:</td>
</tr>
<tr>
<td>Increase</td>
</tr>
<tr>
<td>Decrease</td>
</tr>
</tbody>
</table>
DISCUSSION EXERCISES

MULTIPLE CHOICE

1. Statement 1: Conceptual framework applies in the preparation and presentation of general purpose financial statement geared toward the specific needs of wide range of users.
   Statement 2: Conceptual framework is an integral part of Philippine Financial Reporting Standards (PFRS) and applies specifically to not-for-profit entities.
   A. Only the first statement is true.
   B. Only the second statement is true.
   C. Both statements are true.
   D. Both statements are false.

2. The Conceptual Framework (choose the incorrect statement)
   A. is not a PFRS
   B. in the absence of a standard, shall be considered by management when making its judgment in developing and applying an accounting policy that result in information that is relevant and reliable
   C. is concerned with general-purpose financial statements only
   D. prevails over the PFRSs in cases of conflicts

3. Which of the below presentation of information is correct regarding the purpose of Conceptual Framework?
   I. Assist USERS of Financial Statements – in forming opinion
   II. Assist PREPARERS of Financial Statements – in applying PFRSs
   III. Assist FRSC – in reviewing existing standards
   A. I only
   B. II only
   C. I and III
   D. II and III
   E. None from A, B, C and D

4. Under the New Conceptual Framework, are the following considered as the underlying assumption under the Framework?
   A. Periodicity Assumption
   B. Accrual Basis of Accounting
   C. Monetary Unit Assumption

5. Which of the following is not an implication of the going concern assumption?
   A. The historical cost principle is credible.
   B. Depreciation and amortization policies are justifiable and appropriate.
   C. The current and noncurrent classification of assets and liabilities is justifiable and significant.
   D. Amortizing research and development costs over several periods is justifiable and appropriate.

6. As accounting information users, LENDERS are interested in information
   A. That enables them to determine whether their loans and interests attaching to them will be paid.
   B. About profitability and stability of an entity in order to assess the ability of the entity to provide remuneration, retirement benefits and employment opportunities.
   C. To regulate the activities of the entity, determine taxation policies and as a basis for national income and similar statistics.
   D. About the continuance of an entity especially when they have a long-term involvement with or are dependent on the entity.

7. Which of the above statement(s) is (are) incorrect?
   I. The Framework notes that other parties may find general purpose financial reports useful. However, they are not considered primary users and general purpose financial reports are not primarily directed to them.
   II. The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments.
   A. I only
   B. II only
   C. Both I and II
   D. Neither I nor II

8. According to the Conceptual Framework, neutrality is an ingredient of the fundamental quality of
   I. Relevance
   II. Faithful Representation
   A. Yes, Yes
   B. Yes, No
   C. No, Yes
   D. No, No

9. Which of the following characteristics enhances the quality of information?
   A. Relevant
   B. Timely
   C. Reliable
10. Which of the following statements is incorrect concerning materiality?
   A. Materiality is dependent on professional judgment because no threshold limit is defined in the Conceptual Framework.
   B. Materiality is not a fundamental qualitative characteristic but rather a threshold or cut off point in determining useful information.
   C. Materiality depends on the absolute size of the item or error judged in the particular circumstances of the omission or misstatement.
   D. Information is material if the omission or misstatement could influence the economic decisions that users make on the basis of the financial information about entities.

11. Which of the following statements regarding comparability is incorrect?
   A. The usefulness of financial information is greatly enhanced if it can be compared with information produced by another entity or with similar information prepared in previous periods.
   B. Comparability and consistency are interrelated but they are not the same. Comparability is the means while consistency is the goal.
   C. Information is comparable if it is prepared and presented consistently.
   D. Comparability and consistency are interrelated but they are not the same. Comparability is the goal while consistency is the means.

12. Which of the following is incorrect regarding the reporting entity?
   S1: The reporting is always a legal entity.
   S2: If the financial statements are prepared to include only two subsidiaries only without the parent, the financial statements would be referred to as combined financial statements.
   A. True, false
   B. False, true
   C. False, false
   D. True, true

13. In accordance with Conceptual Framework, which of the following is expressly stated as an element of financial statements?
   I. Gains
   II. Revenue
   III. Income
   IV. Equity
   A. II only
   B. III only
   C. IV only
   D. III and IV

14. Which of the following represents a liability?
   A. The obligation to pay for goods that an entity expects to order from suppliers next year.
   B. The obligation to provide goods that customers have ordered and paid for during the current year.
   C. The obligation to pay interest on a five-year note payable that was issued the last day of the current year.
   D. The obligation to distribute an entity's own shares next year as a result of a stock dividend declared near the end of the current year.

15. An item that meets the definition of an element shall be recognized when
   I. It is probable that future economic benefits associated with the item will flow to or from the entity.
   II. The item has a cost or value that can be measured with reliability.
   A. I only
   B. II only
   C. Either I or II
   D. Both I and II

16. Which of the following correctly shows recognition of items under matching principle?
   I. Depreciation expense - Direct matching
   II. Freight in - Immediate recognition
   III. Doubtful accounts expense - Systematic and rational allocation
   A. I and II
   B. II and III
   C. I and III
   D. I, II, III and IV
   E. Answer not given

17. Which of the following best describes realizable (settlement) value?
   A. Assets are recorded at the amount of cash and cash equivalent paid or the fair value of the consideration given to acquire them at the time of their acquisition.
   B. Assets are carried at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.
   C. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal.
   D. Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business.
18. Recognizing a financial statement element requires measuring it in monetary terms. Which of the following statements is incorrect regarding measurement?
A. The Conceptual Framework only describes measurement bases used in financial reporting but does not specify how a particular financial statement element should be measured – this is addressed by the standards.
B. The Conceptual Framework broadly classifies the measurement bases used in financial reporting into two, namely, historical cost and current value.
C. Measurement uncertainty will always cause the non-recognition of a financial statement element.
D. Measuring a financial statement element often requires estimation.

19. Effective communication makes information more useful. Effective communication requires all of the following except:
A. Focusing on presentation and disclosure objectives and principles rather than focusing on rules.
B. Classifying information in a manner that groups similar items and separates dissimilar items.
C. Aggregating information in such a way that it is not obscured either by unnecessary detail or by excessive aggregation.
D. Using standardized descriptions, a.k.a. ‘boilerplate’, rather than entity-specific information.

20. Under this concept, a profit is earned only if the financial (or money amount of the net assets at the end of the period exceeds the financial or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. It can be measured in either nominal monetary units or units of constant purchasing power.
A. Concept of capital
B. Concept of capital maintenance
C. Financial capital maintenance concept
D. Physical capital maintenance concept

Statement 2: Conceptual Framework is intended to assist auditors in applying the standards in the preparation of financial statements.
A. Only the first statement is true.
B. Only the second statement is true.
C. Both statements are true.
D. Both statements are false.

22. Evaluate whether the following statements are true or false:
I. The characteristic that is demonstrated when a high degree of consensus can be secured among independent measurers using the same measurement methods is neutrality.
II. Physical substance and ownership is a requirement to meet the definition of an asset.
III. An item that has probable economic consequence and can be measured reliably may not be recognized in the financial statements.

<table>
<thead>
<tr>
<th>A.</th>
<th>B.</th>
<th>C.</th>
<th>D.</th>
<th>E.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement I</td>
<td>False</td>
<td>False</td>
<td>True</td>
<td>False</td>
</tr>
<tr>
<td>Statement II</td>
<td>False</td>
<td>True</td>
<td>True</td>
<td>False</td>
</tr>
<tr>
<td>Statement III</td>
<td>True</td>
<td>True</td>
<td>False</td>
<td>False</td>
</tr>
</tbody>
</table>

STRAIGHT PROBLEMS

1. ABRA COMPANY reported that the following changes in account balances during the current year:

<table>
<thead>
<tr>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets 8,900,000</td>
</tr>
<tr>
<td>Liabilities 2,700,000</td>
</tr>
<tr>
<td>Share capital 6,000,000</td>
</tr>
<tr>
<td>Share premium 600,000</td>
</tr>
</tbody>
</table>

Except for a P1,300,000 dividend payment and the year's earnings, there were no changes in retained earnings for the year. What is the net income for the current year?

2. The following information shows the changes in the account balances of VISAYAS INC. during 20x1.

<table>
<thead>
<tr>
<th>Increase (Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash 260,000</td>
</tr>
<tr>
<td>Accounts receivable (2,288,000)</td>
</tr>
<tr>
<td>Allowance for bad debts (312,000)</td>
</tr>
<tr>
<td>Inventory 2,080,000</td>
</tr>
<tr>
<td>Investment in associate 1,820,000</td>
</tr>
<tr>
<td>property, plant and equipment 2,860,000</td>
</tr>
<tr>
<td>Accumulated depreciation 1,040,000</td>
</tr>
<tr>
<td>Accounts payable 2,340,000</td>
</tr>
<tr>
<td>Bonds payable (1,820,000)</td>
</tr>
<tr>
<td>Discount on bonds payable (390,000)</td>
</tr>
<tr>
<td>Share capital 2,340,000</td>
</tr>
<tr>
<td>Share premium 600,000</td>
</tr>
<tr>
<td>Revaluation surplus 2,340,000</td>
</tr>
<tr>
<td>Treasury shares 208,000</td>
</tr>
</tbody>
</table>
Cash dividends declared during 20x1 amounted to P260,000, share dividends declared amounted to P520,000, and appropriations of retained earnings for the retirement of bonds amounted to P130,000. How much is the profit (loss) for the year?

--- END OF HANOUTS ---