Chapter 1

*Student: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_*

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| 1. | Which of the following would NOT be a reason to obtain a greater understanding of accounting practices in other nations?

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| A.  | Financial results are disclosed in different currencies. |

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| B.  | One needs to be aware of differing disclosure requirements from nation to nation, as this impacts the preparation of financial statements. |

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| C.  | Income-smoothing may have affected a foreign subsidiary's results; such smoothing practices are not permitted in North America. |

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| D.  | Departures from the historical cost principle may be possible in other nations. |

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| 2. | Which of the following would be most affected by financial statements being prepared under different accounting principles?

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| --- | --- |
| A.  | Reduced comparability. |

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| B.  | Reduced reliability. |

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| C.  | Increased complexity. |

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| D.  | Inaccurate asset valuations. |

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| 3. | The *CPA Canada Handbook -- Accounting* is the handbook of Canadian accounting standards. Why do companies in Canada ensure that their financial reporting is consistent with Canadian GAAP?

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| A.  | Their bank requires them to do so. |

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| B.  | Their auditors require them to do so. |

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| --- | --- |
| C.  | Reporting under the *CPA Canada Handbook - Accounting* is required by public companies' boards of directors. |

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| D.  | Compliance with the *CPA Canada Handbook - Accounting* pronouncements is usually required by many legal statutes. |

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| 4. | Which decision has Canada made with respect to financial reporting for private enterprises?

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| A.  | To adopt the IFRS standards for small and medium-sized enterprises. |

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| B.  | To retain the current standards. |

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| C.  | To look to US GAAP for standards. |

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| D.  | To develop and maintain its own standards for private enterprises. |

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| 5. | Starting in 2011, what is the definition of a private enterprise (PE) under Canadian GAAP?

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| A.  | A corporation that has no public shareholders. |

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| B.  | A corporation that has less than 500 shareholders and is not listed on a stock exchange. |

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| C.  | A corporation which is not profit oriented. |

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| D.  | A profit oriented enterprise that has none of its issued and outstanding financial instruments traded in a public market and does not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. |

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| 6. | Which enterprises must report under IFRS in Canada?

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| A.  | All corporations, government agencies and private companies. |

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| B.  | Public companies and private companies whose shareholders' equity is in excess of $500,000,000 at any particular year end. |

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| C.  | Public companies, private companies and not-for-profit organizations. |

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| D.  | Publicly accountable enterprises. |

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| 7. | What approach did Canada first decide to take with respect to convergence with IFRS?

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| A.  | Harmonization of *CPA Canada Handbook* with IFRS. |

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| B.  | Substituting IFRS for Canadian GAAP when approved by the IASB. |

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| C.  | Adopting some but not necessarily all IFRSs by reviewing them on a case by case basis. |

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| D.  | Reviewing them with all publically accountable entities to see which ones would be acceptable. |

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| 8. | What choice(s) do private enterprises have in their financial reporting in Canada?

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| A.  | They have no choice at all; they will need to report under IFRS. |

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| B.  | They may elect to continue with differential reporting. |

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| C.  | They may adopt accounting principles that are appropriate to the circumstances. |

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| D.  | They may elect to report under either IFRS or ASPE. |

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| 9. | For which of the following types of organizations does the *CPA Canada Handbook* not provide specific accounting standards?

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| A.  | Publicly accountable enterprises. |

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| B.  | Private enterprises. |

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| C.  | Not-for-profit organizations. |

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| D.  | Proprietorships. |

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| 10. | Which of the following is NOT a reason why a Canadian private company would elect to report under IFRS?

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| --- | --- |
| A.  | The company is planning to go public in the near future. |

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| B.  | The company seeks comparability with public companies of a similar size. |

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| C.  | It is likely to be less expensive than reporting under ASPE. |

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| D.  | The company is a subsidiary of a Canadian public company. |

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| 11. | The current ratio measures:

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| --- | --- |
| A.  | liquidity. |

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| --- | --- |
| B.  | solvency. |

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| C.  | profitability of assets. |

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| D.  | profitability of owners' investment. |

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| 12. | The formula for the current ratio is:

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| A.  | current assets - current liabilities |

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| --- | --- |
| B.  | current assets / current liabilities |

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| --- | --- |
| C.  | total debt / shareholders' equity |

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| D.  | net income / shareholders' equity |

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| 13. | The debt-to-equity ratio measures:

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| --- | --- |
| A.  | liquidity. |

|  |  |
| --- | --- |
| B.  | solvency. |

|  |  |
| --- | --- |
| C.  | profitability of assets. |

|  |  |
| --- | --- |
| D.  | profitability of owners' investment. |

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| 14. | One of the underlying assumptions of the Historical Cost Principle is that a stable unit of measure (currency) should be used for Financial Reporting. Is this always the case?      |

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| 15. | X Inc. and Y Inc. are virtually identical companies with identical cost structures and very similar business practices operating in the same lines of business. X Inc. is a public company based in Canada and follows IFRS while Y Inc. is a private enterprise based in Canada and follows ASPE. The following were the condensed income statements for both companies for the last year before both adopted IFRS.

|  |  |  |
| --- | --- | --- |
|  | **X Inc.** | **Y Inc.** |
| Sales: | $1,000,000 | $2,000,000 |
| Less: |  |  |
| Cost of Goods Sold | $500,000 | $1,600,000 |
| Gross Margin | $500,000 | $400,000 |
| Administrative Expenses | $200,000 | $300,000 |
|  |  |  |
| Net Income: | $300,000 | $100,000 |

Required:Given the information provided, what are some possible causes for the differing results of these companies?      |

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| 16. | Briefly discuss the anticipated changes to accounting standards in Canada over the next few years.      |

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| 17. | What disclosure requirements must be met when a Canadian company adopts IFRS for the first time?      |

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| 18. | List some of the key differences between IFRS and ASPE.      |

Chapter 1 Key

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| 1. | Which of the following would NOT be a reason to obtain a greater understanding of accounting practices in other nations?

|  |  |
| --- | --- |
| **A.**  | Financial results are disclosed in different currencies. |

|  |  |
| --- | --- |
| B.  | One needs to be aware of differing disclosure requirements from nation to nation, as this impacts the preparation of financial statements. |

|  |  |
| --- | --- |
| C.  | Income-smoothing may have affected a foreign subsidiary's results; such smoothing practices are not permitted in North America. |

|  |  |
| --- | --- |
| D.  | Departures from the historical cost principle may be possible in other nations. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #1Learning Objective: 01-01 Describe and apply the conceptual framework for financial reporting.Topic: 01-01 The Conceptual Framework for Financial Reporting* |

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| 2. | Which of the following would be most affected by financial statements being prepared under different accounting principles?

|  |  |
| --- | --- |
| **A.**  | Reduced comparability. |

|  |  |
| --- | --- |
| B.  | Reduced reliability. |

|  |  |
| --- | --- |
| C.  | Increased complexity. |

|  |  |
| --- | --- |
| D.  | Inaccurate asset valuations. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #2Learning Objective: 01-01 Describe and apply the conceptual framework for financial reporting.Topic: 01-01 The Conceptual Framework for Financial Reporting* |

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| 3. | The *CPA Canada Handbook -- Accounting* is the handbook of Canadian accounting standards. Why do companies in Canada ensure that their financial reporting is consistent with Canadian GAAP?

|  |  |
| --- | --- |
| A.  | Their bank requires them to do so. |

|  |  |
| --- | --- |
| B.  | Their auditors require them to do so. |

|  |  |
| --- | --- |
| C.  | Reporting under the *CPA Canada Handbook - Accounting* is required by public companies' boards of directors. |

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| **D.**  | Compliance with the *CPA Canada Handbook - Accounting* pronouncements is usually required by many legal statutes. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #3Learning Objective: 01-01 Describe and apply the conceptual framework for financial reporting.Topic: 01-01 The Conceptual Framework for Financial Reporting* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 4. | Which decision has Canada made with respect to financial reporting for private enterprises?

|  |  |
| --- | --- |
| A.  | To adopt the IFRS standards for small and medium-sized enterprises. |

|  |  |
| --- | --- |
| B.  | To retain the current standards. |

|  |  |
| --- | --- |
| C.  | To look to US GAAP for standards. |

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| **D.**  | To develop and maintain its own standards for private enterprises. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #4Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-05 GAAP for Private Enterprises* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 5. | Starting in 2011, what is the definition of a private enterprise (PE) under Canadian GAAP?

|  |  |
| --- | --- |
| A.  | A corporation that has no public shareholders. |

|  |  |
| --- | --- |
| B.  | A corporation that has less than 500 shareholders and is not listed on a stock exchange. |

|  |  |
| --- | --- |
| C.  | A corporation which is not profit oriented. |

|  |  |
| --- | --- |
| **D.**  | A profit oriented enterprise that has none of its issued and outstanding financial instruments traded in a public market and does not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #5Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-05 GAAP for Private Enterprises* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 6. | Which enterprises must report under IFRS in Canada?

|  |  |
| --- | --- |
| A.  | All corporations, government agencies and private companies. |

|  |  |
| --- | --- |
| B.  | Public companies and private companies whose shareholders' equity is in excess of $500,000,000 at any particular year end. |

|  |  |
| --- | --- |
| C.  | Public companies, private companies and not-for-profit organizations. |

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| **D.**  | Publicly accountable enterprises. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #6Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-04 GAAP for Publicly Accountable Enterprises* |

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| 7. | What approach did Canada first decide to take with respect to convergence with IFRS?

|  |  |
| --- | --- |
| **A.**  | Harmonization of *CPA Canada Handbook* with IFRS. |

|  |  |
| --- | --- |
| B.  | Substituting IFRS for Canadian GAAP when approved by the IASB. |

|  |  |
| --- | --- |
| C.  | Adopting some but not necessarily all IFRSs by reviewing them on a case by case basis. |

|  |  |
| --- | --- |
| D.  | Reviewing them with all publically accountable entities to see which ones would be acceptable. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #7Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-04 GAAP for Publicly Accountable Enterprises* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 8. | What choice(s) do private enterprises have in their financial reporting in Canada?

|  |  |
| --- | --- |
| A.  | They have no choice at all; they will need to report under IFRS. |

|  |  |
| --- | --- |
| B.  | They may elect to continue with differential reporting. |

|  |  |
| --- | --- |
| C.  | They may adopt accounting principles that are appropriate to the circumstances. |

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| --- | --- |
| **D.**  | They may elect to report under either IFRS or ASPE. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #8Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-05 GAAP for Private Enterprises* |

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| 9. | For which of the following types of organizations does the *CPA Canada Handbook* not provide specific accounting standards?

|  |  |
| --- | --- |
| A.  | Publicly accountable enterprises. |

|  |  |
| --- | --- |
| B.  | Private enterprises. |

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| --- | --- |
| C.  | Not-for-profit organizations. |

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| **D.**  | Proprietorships. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #9Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Learning Objective: 01-03 Identify some of the differences between IFRS and ASPE.Topic: 01-04 GAAP for Publicly Accountable EnterprisesTopic: 01-05 GAAP for Private EnterprisesTopic: 01-06 GAAP for Not-for-Profit OrganizationsTopic: 01-07 GAAP for Government and Other Government Organizations* |

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| 10. | Which of the following is NOT a reason why a Canadian private company would elect to report under IFRS?

|  |  |
| --- | --- |
| A.  | The company is planning to go public in the near future. |

|  |  |
| --- | --- |
| B.  | The company seeks comparability with public companies of a similar size. |

|  |  |
| --- | --- |
| **C.**  | It is likely to be less expensive than reporting under ASPE. |

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| D.  | The company is a subsidiary of a Canadian public company. |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #10Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-05 GAAP for Private Enterprises* |

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| 11. | The current ratio measures:

|  |  |
| --- | --- |
| **A.**  | liquidity. |

|  |  |
| --- | --- |
| B.  | solvency. |

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| --- | --- |
| C.  | profitability of assets. |

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| --- | --- |
| D.  | profitability of owners' investment. |

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| *Accessibility: Keyboard NavigationBlooms: ComprehensionBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #11Learning Objective: 01-04 Analyze and interpret financial statements to assess the impact of different accounting methods on key financial statement ratios.Topic: 01-08 Analysis and Interpretation of Financial Statements* |

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| 12. | The formula for the current ratio is:

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| --- | --- |
| A.  | current assets - current liabilities |

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| --- | --- |
| **B.**  | current assets / current liabilities |

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| C.  | total debt / shareholders' equity |

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| --- | --- |
| D.  | net income / shareholders' equity |

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| *Accessibility: Keyboard NavigationBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #12Learning Objective: 01-04 Analyze and interpret financial statements to assess the impact of different accounting methods on key financial statement ratios.Topic: 01-08 Analysis and Interpretation of Financial Statements* |

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| 13. | The debt-to-equity ratio measures:

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| --- | --- |
| A.  | liquidity. |

|  |  |
| --- | --- |
| **B.**  | solvency. |

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| --- | --- |
| C.  | profitability of assets. |

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| --- | --- |
| D.  | profitability of owners' investment. |

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| *Accessibility: Keyboard NavigationBlooms: ComprehensionBlooms: KnowledgeDifficulty: EasyGradable: automaticHilton - Chapter 01 #13Learning Objective: 01-04 Analyze and interpret financial statements to assess the impact of different accounting methods on key financial statement ratios.Topic: 01-08 Analysis and Interpretation of Financial Statements* |

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| 14. | One of the underlying assumptions of the Historical Cost Principle is that a stable unit of measure (currency) should be used for Financial Reporting. Is this always the case?  The Historical Cost Principle is not very useful when inflation rates are high. As a result of the eroding purchase power associated with periods of high inflation, many countries have had to experiment with price-level adjustments. These adjustments often include asset revaluations to reflect their current values. |

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| *Blooms: ComprehensionBlooms: KnowledgeDifficulty: EasyGradable: manualHilton - Chapter 01 #14Learning Objective: 01-01 Describe and apply the conceptual framework for financial reporting.Topic: 01-01 The Conceptual Framework for Financial ReportingTopic: 01-02 Professional Judgment* |

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| 15. | X Inc. and Y Inc. are virtually identical companies with identical cost structures and very similar business practices operating in the same lines of business. X Inc. is a public company based in Canada and follows IFRS while Y Inc. is a private enterprise based in Canada and follows ASPE. The following were the condensed income statements for both companies for the last year before both adopted IFRS.

|  |  |  |
| --- | --- | --- |
|  | **X Inc.** | **Y Inc.** |
| Sales: | $1,000,000 | $2,000,000 |
| Less: |  |  |
| Cost of Goods Sold | $500,000 | $1,600,000 |
| Gross Margin | $500,000 | $400,000 |
| Administrative Expenses | $200,000 | $300,000 |
|  |  |  |
| Net Income: | $300,000 | $100,000 |

Required:Given the information provided, what are some possible causes for the differing results of these companies?  There could be many possible explanations for these differing results. Y Inc.'s net income is $100,000, compared to X Inc.'s $300,000. Conversely, Y Inc.'s sales are twice those of X Inc. What is particularly noteworthy is Y Inc.'s 20% gross margin compared to X Inc.'s 50% gross margin. This could be due to the accelerated depreciation on Y Inc.'s property, plant and equipment or provisions made for future maintenance costs.Smoothing practices may have been applied to reduce Y Inc.'s income, and of course, its tax liability. Y Inc.'s income may have been further reduced by higher estimates (for example: bad debt expense, warranty costs and so forth) which are not necessarily be indicative of economic conditions.Note: Once again, the above analysis is not necessarily exhaustive. Students may be able to identify other valid differences. |

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| *Blooms: ComprehensionBlooms: KnowledgeDifficulty: ModerateGradable: manualHilton - Chapter 01 #15Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Learning Objective: 01-03 Identify some of the differences between IFRS and ASPE.Topic: 01-03 Accounting Standards in CanadaTopic: 01-04 GAAP for Publicly Accountable EnterprisesTopic: 01-05 GAAP for Private Enterprises* |

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| --- | --- |
| 16. | Briefly discuss the anticipated changes to accounting standards in Canada over the next few years.  1. The format and structure of financial statements may change to present a cohesive relationship between the various statements;2. The Conceptual Framework will be revised to create a sound foundation for future accounting standards that are principles based, internally consistent, and internationally converged. Relevance and faithful representation will be the fundamental qualitative characteristics of financial information. The definitions of assets and liabilities may change to focus more on rights and obligations to eliminate the reference to past events. When and how to use various measurement bases may be clarified. |

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| *Blooms: ComprehensionBlooms: KnowledgeDifficulty: EasyGradable: manualHilton - Chapter 01 #16Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-03 Accounting Standards in CanadaTopic: 01-04 GAAP for Publicly Accountable EnterprisesTopic: 01-05 GAAP for Private Enterprises* |

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| 17. | What disclosure requirements must be met when a Canadian company adopts IFRS for the first time?  1. The company must reconcile its equity reported under the previous GAAP to its equity in accordance with IFRS for both the date of transition to IFRS and the end of the latest period reported under the previous GAAP.2. The company must reconcile its total comprehensive income in accordance with IFRS to that reported in the latest statements prepared under the previous GAAP.3. The company must provide sufficient detail to enable users to understand the material adjustments to the statement of financial position, the statement of comprehensive income and the statement of cash flows. |

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| *Blooms: KnowledgeDifficulty: EasyGradable: manualHilton - Chapter 01 #17Learning Objective: 01-02 Describe how accounting standards in Canada are tailored to different types of organizations.Topic: 01-03 Accounting Standards in CanadaTopic: 01-04 GAAP for Publicly Accountable Enterprises* |

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| 18. | List some of the key differences between IFRS and ASPE.  Some key differences between IFRS and ASPE are:> disclosure> impaired loans> property, plant, and equipment revaluation option> asset impairment (test for impairment if indicator requires, and subsequent reversal of impairment loss)> development costs> post-employment benefits (recognition of actuarial gains/losses)> income taxes> interest capitalization> compound financial instruments> preferred shares in tax planning arrangements> value of conversion option for convertible bonds(See Exhibit 1.1 "Some Key Differences between IFRS and ASPE" for a full list and a description of the difference.) |

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| *Blooms: KnowledgeDifficulty: ModerateGradable: manualHilton - Chapter 01 #18Learning Objective: 01-03 Identify some of the differences between IFRS and ASPE.Topic: 01-03 Accounting Standards in CanadaTopic: 01-04 GAAP for Publicly Accountable EnterprisesTopic: 01-05 GAAP for Private Enterprises* |

Chapter 1 Summary

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