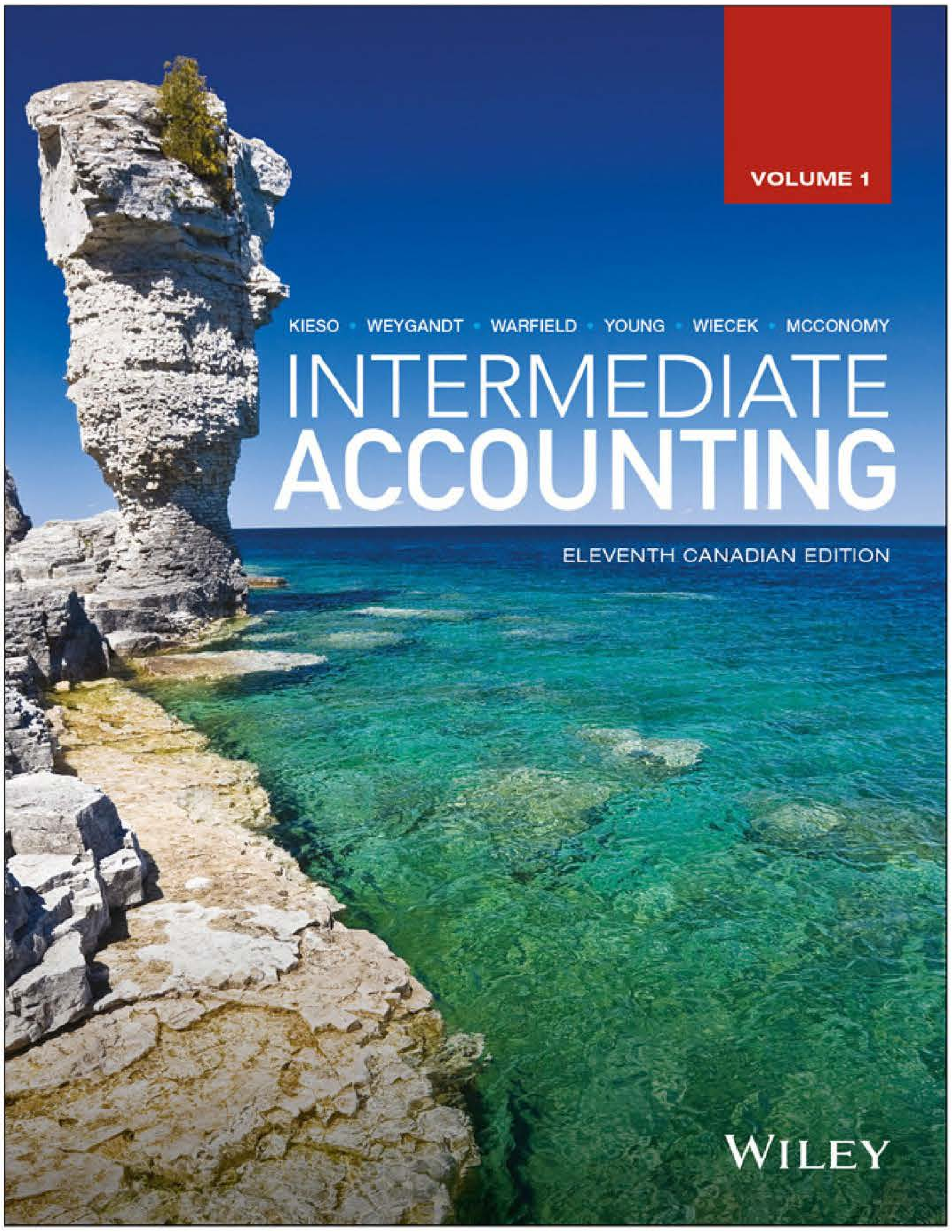
STUDENT STUDY GUIDE TO ACCOMPANY

INTERMEDIATE ACCOUNTING

VOLUME 1 | ELEVENTH CANADIAN EDITION

KIESO • WEYGANDT • WARFIELD • YOUNG • WIECEK • McCONOMY



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Intermediate Accounting

VOLUME 1: CHAPTERS 1 – 12

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Preface

To the Student

The purpose of this study guide is to help you to improve your success rate in solving accounting homework assignments and in answering accounting exam questions. For each chapter we include the following:

OVERVIEW	To briefly introduce the chapter topics and their importance.
STUDY STEPS	To discuss the business transactions or issues pertinent to the chapter topics, including an analysis of key recognition, measurement, and disclosure issues.
TIPS	To alert you to common pitfalls and misconceptions and remind you of important terminology, concepts, and relationships that are relevant to answering specific questions or solving certain problems.
EXERCISES	To provide you with a selection of problems representative of homework assignments that an intermediate accounting student may encounter.
MULTIPLE CHOICE	To provide you with a selection of multiple-choice questions that are representative of common exam questions covering topics in the chapter.
PURPOSES	To identify the essence of each question or exercise and link it to the text material.
SOLUTIONS	To show you the appropriate solution for each exercise and multiple-choice question presented.
EXPLANATIONS	To give you the details of how selected solutions were derived and explain why things are done as shown.
APPROACHES	To coach you on the particular model, computational format, or other strategy to be used to solve particular problems. To teach you how to analyze and solve multiple-choice questions.

This book will provide you with the opportunity to solve accounting problems in addition to the ones assigned by your instructor without having to rely on your teacher for solutions. Many of the exercises and questions contained herein are very similar to material in your intermediate accounting textbook; the difference is, the ones in this book are accompanied with detailed, clearly laid-out solutions.

The use of the multiple-choice questions in this volume and the related suggestions on how to approach them can easily increase your ability (and confidence in your ability) to deal with exam questions of this variety.

HOW TO STUDY ACCOUNTING

The successful study of accounting requires a different approach than most other subjects. In addition to reading a chapter, applying the material through completion of exercises or problems is necessary in developing a true and lasting understanding of the concepts introduced in the text chapter. The study of accounting principles is a combination of theory and practice; theory describes what to do and why, and practice is the application of guidelines to actual situations. We use illustrations to demonstrate how theory works and we use theory to explain why something is done in practice. Therefore, it is impossible to separate the two in the study of accounting.

Learning accounting is a cumulative process. It is difficult to master Chapter 4 until you are thoroughly familiar with chapters 1–3, and so on. Therefore, it is imperative that you keep up with class assignments. And, because accounting is a technical subject, you must pay particular attention to terminology.

Accounting is the language of business. It is an exciting subject that provides a challenge for most business majors. Your ultimate success in life may well depend on your ability to grasp financial data. The effort you expend now will provide rewards for years to come.

We encourage you to follow the four steps for study outlined below to give yourself the best possible chance for a successful learning experience and to make the most efficient use of your time. These steps provide a system of study for each chapter in your text.

Step 1

- Scan the learning objectives at the beginning of each chapter.
- Scan the chapter (or chapter section).
- Glance over the questions at the end of the chapter.

This first step will give you an overview of the material to be mastered.

Step 2

- Read the assigned pages slowly.
- Study carefully, and mark for later attention any sections requiring review.

- Pay particular attention to examples and illustrations.
- Try to formulate tentative answers to end-of-chapter questions.

During this phase, you will be filling in the chapter "outline" you formed in Step 1. Most of the details will fall into place during this phase of your study. The remaining steps are necessary, however, for a keen understanding of the subject.

Step 3

- Carefully read the **Overview**, **Study Steps**, and **Tips** sections of this study guide.
- Do the **Exercises** and **Cases** in this study guide that pertain to the same topics as your homework assignments.
- Review the relevant **Illustrations** in this study guide.
- Do the **Multiple-Choice Questions** in the study guide that pertain to the same topics as your homework assignments.
- Refer back to the text chapter sections that you marked for review, if any. It is likely that any confusion or questions will have been cleared up through your work in the study guide. If a section remains unclear, carefully reread it and rework relevant pages of the study guide.
- Repeat this process for each assigned topic area.

Step 4

- Write out formal answers to homework assignments in the text. This step is crucial because you can determine whether you can independently apply the material you have been studying to new situations. You may find it necessary to go back to the text and/or the study guide to restudy certain sections. This is common and a good indicator that the study assignments are working for you.

Here is some additional guidance to help you get the most out of this study guide:

The **Study Steps** and **Tips**, along with the **Illustrations**, will aid your understanding and retention of the material. Exercises provide examples of application of the text material. These should be very valuable in giving you guidance in completing homework assignments that are often similar in nature and content.

The **Approach** stated for an exercise or question is likely the most valuable feature of this study guide because it provides guidance on how to think through the situation at hand. This thought process can then be used in similar situations. It is impossible to illustrate every situation you may encounter. You can, however, handle new situations by simply applying what you know and making modifications where appropriate. Many students make the mistake of attempting to memorize their way through an accounting book. That, too, is an impossible feat. **Do not rely on memorization.** If this material is going to be useful to you, you must think about what you are reading and always be thinking of why things are as they are.

If you know the reasoning for a particular accounting treatment, it will be much easier to remember that treatment and reconstruct it even weeks after your initial study of it.

Explanations are provided for exercises and questions. These are very detailed so that you will thoroughly understand what is being done and why. These details will serve you well when you complete your homework assignments.

Always make an honest effort to solve the exercises and answer the questions contained in this study guide **before** you look at the solutions. Answering the questions on your own will maximize the benefits you can expect from this book.

The **Multiple-Choice Questions** are self-tests to give you immediate feedback on how well you understand the material. Study the **Approaches** suggested for answering these questions in the study guide. Practise the approaches when answering the multiple-choice questions in the text. Apply them when taking examinations. By doing so, you will learn to calmly, methodically, and successfully process examination questions. This will very likely improve your exam scores.

When you work through an **Exercise** or **Case** in the study guide or in the text, always read the instructions **before** you read all of the given data. This allows you to determine what is being asked of you and what you are to accomplish, before you read the given data. As you tread through the data, you can begin to process it because you can determine its significance and relevance. If you read the data before the instructions, you will likely waste time having to reread the data after you find out what you are to do with it. Also, more importantly, reading the data before the instructions will likely cause you to begin anticipating what will be asked of you, which will often cause you to do analysis other than what is required of you.

Good luck and best wishes for a positive learning experience!

Chapter 1

The Canadian Financial Reporting Environment

OVERVIEW

Accounting is the language of business. Accountants identify, measure, and communicate financial information about economic entities to interested persons. To be useful, financial statements must be clearly understandable and comparable, so that users may compare the performance of one business with the performance of the same business in a prior period, or with the performance of another similar business. Therefore, all general purpose financial statements should be prepared in accordance with generally accepted accounting principles (GAAP). In Canada, the financial statements of private companies should be prepared in accordance with Accounting Standards for Private Enterprises (ASPE) as set out by the AcSB (Canadian Accounting Standards Board), unless they opt to use international GAAP (called International Financial Reporting Standards, or IFRS). ASPE was effective for Canadian private companies for periods beginning on or after January 1, 2011. Financial statements of public companies should be prepared in accordance with IFRS. IFRS is set out by the IASB (International Accounting Standards Board). IFRS was effective for Canadian public companies for periods beginning on or after January 1, 2011.

STUDY STEPS

Understanding the Financial Reporting Environment

It is important to recognize preparer, standard setter, and user perspectives in understanding the financial reporting environment. A company's management prepares financial statements, in accordance with GAAP set by accounting standard-setting bodies, primarily to assist users in making efficient resource (or capital) allocation decisions. Investors need information about the past performance of a company in order to determine whether they should invest in the company. Financial statements should provide information about whether the company is profitable, whether it has paid dividends in the past, and whether it can stay solvent.

It is not necessary to memorize lists of potential users and what their information needs are. However, an understanding of key stakeholders and their respective functions is critical in understanding the financial reporting environment.

For the most efficient and effective flow of capital, there should be information symmetry, meaning that all stakeholders should have equal access to all relevant information. However, perfect information symmetry does not exist in the markets, resulting in an inefficient capital marketplace. The two most common types of information asymmetry problems are adverse selection and moral hazard. Moral hazard is a concept that notes that people will often shirk their responsibilities if they think that no one is watching. If biased managers prepare financial information by overstating assets and/or revenues, or understating liabilities and/or expenses (resulting in aggressive accounting), the financial information they prepare will be less useful to financial statement users, resulting in a less efficient and less effective flow of capital in the capital marketplace.

GAAP, the GAAP Hierarchy, and Professional Judgement

Generally accepted accounting principles (GAAP) provide guidance to accountants in meeting the financial reporting objective of providing financial information that is useful to users and that is decision-relevant. GAAP acts as guidelines to ensure that certain reporting standards are met. For private companies, pension plans, and not-for-profit entities, GAAP is codified in the *CICA Handbook* (produced by the Canadian Institute of Chartered Accountants). For public companies, GAAP is codified in IFRS and IAS (International Accounting Standards). IAS were issued by the IASC (International Accounting Standards Committee), IASB's predecessor, between 1973 and 2001. In general, the term "IFRS" is understood to comprise both IFRS and IAS.

Since no specific rule can be phrased to suit every situation, the guidelines in IFRS and ASPE are quite often general in nature and usually provide a basic principle. For instance, in determining when revenue should be recognized, the traditional earnings approach suggests that revenue should be recognized when performance is substantially complete and collection is reasonably assured. This general guideline is applied in numerous situations and often requires professional judgement in application. A basic principle is preferable to having a rule such as "all revenue must be recognized when goods are shipped." While such a rule would be easy to follow and very clear, it might result in inappropriate accounting. (For example, what if goods are shipped on consignment?) An alternative to the earnings approach to revenue recognition is emerging, called the contract-based approach, which addresses some of the subjectivity in applying the earnings approach. Both approaches are discussed further in Chapter 6.

Therefore, although GAAP provides guidance, it is often of a general nature, requiring interpretation, which in turn requires professional judgement in application. The GAAP guidelines in IFRS and ASPE do not fit every situation, and there may be situations that the guidelines do not specifically cover. The GAAP hierarchy identifies, in order of authority, sources that should be consulted in applying GAAP, beginning with the most authoritative (or primary) sources.

For private companies, pension plans, and not-for-profit entities, the primary sources of GAAP are as follows:

- *CICA Handbook* Sections 1400–3870, including Appendices; and
- Accounting guidelines, including Appendices.

Other sources include:

- Background information and basis for conclusion documents issued by the AcSB
- AcSB implementation guidance
- Pronouncements by accounting standard-setting bodies in other jurisdictions
- Approved drafts of primary sources of GAAP
- Research studies
- Accounting textbooks, journals, studies, and articles
- Other sources including industry practice

For public entities, the primary sources of GAAP are as follows:

- IFRS
- IAS
- IFRIC (International Financial Reporting Interpretation Committee) interpretations

Other sources include:

- Pronouncements of other standard-setting bodies
- Other accounting literature
- Accepted industry practices

In general, primary sources must be looked to first. Where primary sources do not deal with the specific issue at hand, the entity should adopt accounting policies that are consistent with primary sources as well as the concepts laid out in the conceptual framework underlying financial reporting (to be discussed in Chapter 2).

Management Bias in Reporting and Ethical Considerations

Another key thing to remember is that financial statements are prepared by people, often the management of the company. Therefore, there are behavioural aspects to financial reporting. People are not perfect and often act in a self-serving manner. For instance, if a manager knows that shareholders will evaluate his performance based on the company's net income, he might be motivated to report net income higher than it really is.

Reporting bias defeats the purpose of financial reporting since, in the case above, the manager's real performance might be obscured and the shareholders may make an incorrect decision based on the information presented. Where financial statements are prepared in accordance with GAAP, this problem may not be as severe, since the manager will have to follow GAAP (and GAAP will constrain his accounting policy choices). Public companies are required to hire an outside, independent auditor to review financial statements for fairness, which alleviates some of the risk. Outside (external) **auditors** add value because they perform an unbiased, independent review of financial statements to ensure that the information is presented fairly in accordance with GAAP.

TIPS ON CHAPTER TOPICS

- Potential **management bias** may play a key role in the development and choice of accounting policies chosen by management. This should always be kept in mind when analyzing a set of financial statements. Management bias may take the form of overstating assets or revenues, or understating liabilities or expenses.
- Consider the motivations of those who are involved in preparing financial statements. They might not always be pure.
- Because most business owners (shareholders of corporations) are not involved with the operation of the business, the **stewardship function** (measuring and reporting data to absentee owners) is an important function of accounting. This situation greatly increases the need for accounting standards.
- The accounting profession has common standards and procedures called **generally accepted accounting principles** (often referred to as GAAP). The term "generally accepted" can mean either that an authoritative accounting rule-making body has established a principle of reporting in a given area or that over time a given practice has been accepted as appropriate because of its universal application.
- The terms **principles** and **standards** are used interchangeably in practice and throughout this book.
- Accounting is a constantly changing and evolving profession, as seen by Canada's shift to IFRS for public companies. By adopting international

GAAP that nearly 100 other countries have converged to, Canadian public companies are better able to stay competitive globally.

- A private company in Canada may choose to adopt IFRS, even if most of its business is done within Canada. For example, if a private company competes against foreign companies or other Canadian public companies for sales contracts or financing, it may be better able to compete if it adopts the same financial reporting standards as its competitors.
- Standard setting is a political process and therefore GAAP itself is sometimes a compromise. This means that a treatment prescribed in the *CICA Handbook*, for example, may not necessarily agree with the conceptual framework underlying the GAAP therein.
- There are over 150 different sets of GAAP around the world. Countries or groups of countries each have their own GAAP to meet their unique needs, objectives, and conditions (just as Canada has its own GAAP for private enterprises, ASPE). The GAAP of one country may or may not be the same for the same situation in another country. Harmonization in favour of an international GAAP is a main focus of many accounting standard setters to eliminate barriers and improve comparability.
- Although the **International Accounting Standards Board** (IASB) is quickly becoming the dominant accounting standard-setting body in the world, full global adoption of international GAAP and IFRS is still far away. For example, many countries (including Canada) are maintaining their separate national GAAP for private companies, but requiring that public companies follow IFRS.
- The United States has not migrated to IFRS, and whether it will remains to be seen.
- The primary focus of this textbook concerns the development of two types of financial information, which are governed by GAAP: (1) the basic financial statements and (2) the related note disclosures.
- The **basic financial statements** are: (1) the statement of financial position (or the balance sheet under ASPE), (2) the statement of income/comprehensive income (or the income statement under ASPE), (3) the statement of cash flows, and (4) the statement of changes in equity (or statement of retained earnings under ASPE). In addition, note disclosures and other supporting schedules are an integral part of the financial statements.
- The **accrual basis of accounting** is used in preparing the basic financial statements. The accrual basis requires (1) reporting revenues in the period in which they are earned (which may not be the same period in which the related cash is received), and (2) reporting expenses in the period in which they are incurred (which may not be the same period in which the related cash is paid).
- Accounting decisions are not made in a "vacuum." Besides GAAP, many factors influence how a particular transaction is accounted for, including who makes the accounting policy decision, who the end user of the financial information is, and how similar transactions are accounted for in practice.
- Accounting guidelines are not always "black and white." There are many "grey" areas that require **professional judgement**.
- **Auditors** add value because they perform an independent review of financial statements, providing assurance that GAAP has been followed.

CASE 1-1

PURPOSE: This case will review the meaning of generally accepted accounting principles (GAAP) and their significance.

All publicly accountable entities must have their annual financial statements audited by an independent accountant. In accordance with generally accepted auditing standards (which you will study in an auditing class), the auditor expresses an opinion regarding the fairness of the financial statements, which, for a publicly accountable entity, should be in accordance with International Financial Reporting Standards (IFRS).

Instructions

(a) Define generally accepted accounting principles.
(b) List the primary sources of IFRS.

Solution to Case 1-1

(a) The accounting profession refers to common accounting standards and procedures as **generally accepted accounting principles** (GAAP). The word "principles" refers to methods or procedures or standards. The phrase "generally accepted" means having "substantial authoritative support." A method has substantial authoritative support if a rule-making body has approved it or if it has gained acceptance over time because of its universal application in practice.

(b) The primary sources of IFRS (where one should look first for guidance in applying international GAAP) are the following:

- IFRS
- IAS
- IFRIC (International Financial Reporting Interpretation Committee) interpretations

Where these sources do not deal with a particular issue, it is recommended that one look to:

- Pronouncements of other standard-setting bodies (for example, the FASB in the United States)
- Other accounting literature
- Accepted industry practices

ANALYSIS OF MULTIPLE-CHOICE QUESTIONS

Question

1. The process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, evaluate, and control an organization's operations is called:
   a. financial accounting.
   b. managerial accounting.
   c. tax accounting.
   d. auditing.

EXPLANATION: **Financial accounting** is the process that culminates in the preparation of financial reports for the enterprise as a whole for use by parties both internal and external to the enterprise. (Users of these financial reports include investors, creditors, managers, unions, and government agencies.) **Managerial accounting** is the process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, evaluate, and control an organization's operations. (These reports are only for the use of parties internal to the enterprise.) **Tax accounting** usually refers to tax planning, advising on tax matters, and/or preparing tax returns. **Auditing** refers to examination of financial statements by a certified accountant who reviews the information to ensure that management is accounting for economic transactions properly. An auditor attests to the fairness of financial statements and their conformity to generally accepted accounting principles. (Solution = b.)

Question

2. One objective of financial reporting is to provide:
   a. information about the investors in the business entity.
   b. information about the liquidation values of the resources held by the enterprise.
   c. information that is useful in resource allocation decisions.
   d. information that will attract new customers.

EXPLANATION: Before you read the possible answers, think about the overall objective of financial reporting and the key words and concepts within. The overall objective of financial reporting is to provide financial information that is useful to users (primarily capital providers such as investors and lenders) and that is relevant in users' capital (or resource) allocation decisions. Consequently, financial statements should communicate information about:

- an entity's economic resources and claims to those resources, and
- changes in those resources and claims. (Solution = c.)

Question

3. The measuring and reporting of data to absentee owners of a corporation is referred to as management's:
   a. fiduciary responsibility.
   b. stewardship function.
   c. accounting standard-setting function.
   d. audit function.

EXPLANATION: Management's responsibility to manage assets with care and trust is its **fiduciary responsibility**. Management does not set accounting standards. Audits are conducted by independent accountants, not management. The **stewardship function** involves measuring and reporting data to absentee owners. (Solution = b.)

Question

4. For public companies in Canada, the most significant source of generally accepted accounting principles is:
   a. provincial securities commissions.
   b. the FASB.
   c. the IASB.
   d. the AcSB.

EXPLANATION: Provincial securities commissions oversee and monitor the capital marketplace, including stock exchanges. The FASB (Financial Accounting Standards Board) is the primary standard-setting organization in the United States (the CICA counterpart in the United States). The AcSB (Canadian Accounting Standards Board) develops and maintains ASPE in Canada. The IASB (International Accounting Standards Board) is the international organization that develops IFRS, which public companies in Canada must conform to. (Solution = c.)

Question

5. Accounting assists in the efficient allocation of scarce resources (or capital) by providing financial information that is:
   i. timely.
   ii. representationally faithful.
   iii. relevant.

   a. i only.
   b. i and ii.

c. i and iii.
d. All of the above.

Explanation: An effective process of capital allocation promotes productivity, encourages innovation, and provides an efficient and liquid market for buying and selling of securities and debt. Think about the role of accounting information in this process. Unreliable and irrelevant information can lead to poor capital allocation. To be useful, information must be relevant to the decision-maker, it must be received in a timely manner, and it must be representationally faithful. (Solution = d.)

Question

6. All of the following organizations influence the development of financial reporting standards in Canada, except the:
   a. Canada Revenue Agency (CRA).
   b. Accounting Standards Board (AcSB).
   c. International Accounting Standards Board (IASB).
   d. Financial Accounting Standards Board (FASB).

Explanation: The Canada Revenue Agency (CRA) is responsible for developing rules surrounding and administering federal income tax in Canada. Although the CRA influences accounting practice, it does not influence the development of financial reporting standards as the other organizations do. (Solution = a.)

Question

7. The *CICA Handbook* is divided into four parts, including all of the following, except:
   a. EIC Abstracts.
   b. Accounting Standards for Private Enterprises.
   c. Accounting Standards for Not-for-Profit Organizations.
   d. Accounting Standards for Pension Plans.

Explanation: In the past, EIC Abstracts were issued by the Emerging Issues Committee to study and provide rulings for issues not covered or sufficiently dealt with in the *CICA Handbook*. (They were not technically part of the *CICA Handbook*.) In 2009, it was decided that any relevant material from EIC Abstracts to date would be incorporated into their respective *CICA Handbook* sections, and that EIC Abstracts would be withdrawn once Canada moved to IFRS for publicly accountable entities in 2011. The *CICA Handbook* is now divided into four parts: Part I – IFRS (for publicly accountable enterprises), Part II – Accounting Standards for Private Enterprises, Part III – Accounting Standards for Not-for-Profit Organizations, and Part IV – Accounting Standards for Pension Plans. (Solution = a.)

Question

8. Which of the following groups is not part of the governing structure of the IASB?
   a. The IASC Foundation
   b. The IFRS Advisory Council
   c. Securities commissions
   d. The International Financial Reporting Interpretation Committee (IFRIC)

EXPLANATION: The IASC Foundation monitors, reviews the effectiveness of, appoints members to, and funds the IASB. The IFRS Advisory Council is composed of various user groups that provide guidance and feedback to the IASB. The IFRIC studies issues where guidance in IASB is insufficient or non-existent. (Solution = c.)

Question

9. Which of the following steps is not typical in the evolution of a new or revised IFRS?
   a. Discussion Paper is issued.
   b. Topic is identified and placed on the Board's agenda.
   c. Exposure Draft is issued.
   d. Discussions are held with governments for final approval of addition or amendment.

EXPLANATION: Think about the steps involved in the process of producing a new or revised IFRS:
   i. Through research, topics are identified and placed on the Board's agenda.
   ii. Discussion Paper is produced and issued for comment by the public.
   iii. Exposure Draft is produced and issued for comment by the public.
   iv. Board evaluates comments and changes Exposure Draft, if necessary. The final IFRS is issued, followed by a jurisdictional adoption process.

   The IASB does not have to consult with any governments prior to final approval of a new or revised IFRS. (Solution = d.)

Question

10. The essential characteristics of financial accounting involve:
    a. identification and measurement of financial information relating to an economic entity.
    b. identification, measurement, and communication of financial information about an economic entity to interested persons.
    c. identification, measurement, and communication of financial information about an economic entity to management.

d. identification and communication of financial information about an economic entity to management.

EXPLANATION: Financial accounting involves identification, measurement, and communication of relevant information to all interested decision-makers, whether they are internal or external. (Solution = b.)

Question

11. Under IFRS, a complete set of financial statements includes:
    a. statement of financial position, statement of income/comprehensive income, statement of cash flows, statement of changes in equity, and note disclosures.
    b. statement of financial position, statement of income/comprehensive income, and statement of cash flows.
    c. statement of financial position and statement of income/comprehensive income.
    d. statement of financial position, statement of comprehensive income, and note disclosures.

EXPLANATION: Under IFRS, a complete set of financial statements includes a statement of financial position, statement of income/comprehensive income, statement of cash flows, statement of changes in equity, and note disclosures. (Solution = a.)

Question

12. Under ASPE, a complete set of financial statements includes:
    a. balance sheet, income statement, statement of cash flows, statement of retained earnings, and note disclosures.
    b. balance sheet, income statement, and statement of cash flows.
    c. balance sheet and income statement.
    d. balance sheet, income statement, and note disclosures.

EXPLANATION: Under ASPE, a complete set of financial statements includes a balance sheet, income statement, statement of cash flows, statement of retained earnings, and note disclosures. (Solution = a.)

Question

13. Explain the meaning of **stakeholder** within the context of financial reporting.
    a. A stakeholder is someone who has something at risk in the financial reporting environment.
    b. Stakeholders include only parties external to the company.

c. Stakeholders include only those parties who own or work for a company.
d. A stakeholder has no vested interest in the financial reporting environment.

EXPLANATION: **Stakeholders** are interested parties who have something to gain or lose in the financial reporting environment. For example, an auditor stands to lose her reputation and an investor stands to increase his investment. Therefore, stakeholders are not restricted to those internal to the company. (Solution = a.)

Question

14. Which of the following statements best describes the notion of management bias within the context of financial reporting?
    a. Management bias involves management intentionally misstating financial statements for personal gain.
    b. Management bias results in financial statements that are not neutral and, therefore, not useful.
    c. Management bias is unavoidable.
    d. Management bias involves management intentionally misstating financial statements so that the company can raise funds in capital markets.

EXPLANATION: Recall that the bias of a preparer may affect the quality (and, therefore, usefulness) of the information being prepared. By definition, biased information is not useful. Management bias is avoidable with proper controls in place and transparent financial reporting. (Solution = b.)

Question

15. Explain the significance of professional judgement in applying GAAP.
    a. Professional judgement does not exist in GAAP since it contradicts the concept of comparability.
    b. Professional judgement allows management to contradict IFRS or ASPE.
    c. Professional judgement is rarely used in applying GAAP.
    d. Professional judgement is often required since IFRS and ASPE consist of general principles that need to be interpreted in practice.

EXPLANATION: The use of professional judgement is often necessary and allows flexibility in order to meet the objective of providing financial information that is fair, useful, and decision-relevant. However, if there is a standard in IFRS or ASPE requiring a specific accounting treatment, the IFRS or ASPE standard would take precedence. (Solution = d.)