

Exercises

STAR RATING ★ BASIC ★★ MODERATE ★★★ DIFFICULT

Exercise 1.9 RELEVANT INFORMATION FOR AN INVESTMENT COMPANY

- ★ A year ago you bought shares of stock in an investment company. The investment company in turn buys, holds and sells shares of business enterprises. You want to use the financial statements of the investment company to assess its performance over the past year.
 - (a) What financial information about the investment company's holdings would be most relevant to you?
 - (b) The investment company earns profits from appreciation of its investment securities and from dividends received. How would the concepts of recognition in the *Conceptual Framework* apply here?

Exercise 1.10 FINANCIAL STATEMENTS OF A REAL ESTATE INVESTOR

- ★ An entity purchases a rental property for \$10 000 000 as an investment. The building is fully rented and is in a prosperous area. At the end of the current year, the entity hires an appraiser who reports that the fair value of the building is \$15 000 000 plus or minus 10%. Depreciating the building over 50 years would reduce the carrying amount to \$9 800 000.
 - (a) What are the relevance and faithful representation considerations in deciding how to measure the building in the entity's financial statements?
 - (b) Does the *Conceptual Framework* lead to measuring the building at \$15 000 000? Or at \$9 800 000? Or at some other amount?

Exercise 1.11 MEANING OF 'DECISION USEFUL'

- ★ What is meant by saying that accounting information should be 'decision useful'? Provide examples.

Exercise 1.12 PERFORMANCE OF A BUSINESS ENTITY

- ★ A financial analyst says: 'I advise my clients to invest for the long term. Buy good stocks and hang onto them. Therefore, I am interested in a company's long-term earning power. Accounting standards that result in earnings volatility obscure long-term earning power. Accounting should report earning power by deferring and amortising costs and revenues.' How does the *Conceptual Framework* relate to this analyst's view of financial statements?

Exercise 1.13 GOING CONCERN

- ★ What measurement principles might be most appropriate for a company that has ceased to be a going concern (e.g. it is unable to renew loans and is planning to sell major assets needed for existing operations in order to repay creditors)?

Exercise 1.14 DEFINITIONS AND RECOGNITION CRITERIA

- ★ Explain how you would account for the following items, justifying your answer by reference to the definitions and recognition criteria in the *Conceptual Framework*. Also state, where appropriate, which ledger accounts should be debited and credited.
 - (a) (i) Your firm has been sued for negligence — likely you will lose the case.
 - (ii) Your firm has been sued for negligence — likely you will win the case.
 - (b) Obsolete plant now retired from use.
 - (c) Receipt of a donation of \$10 000.

Exercise 1.15 DEFINITIONS AND RECOGNITION CRITERIA

- ★ Glasgow Accounting Services has just invoiced one of its clients \$3600 for accounting services provided to the client. Explain how Glasgow Accounting Services should recognise this event, justifying your answer by reference to relevant *Conceptual Framework* definitions and recognition criteria.