

Chapter 3 Introduction to Accounting

Section 4

Accounting Assumptions, Principles and Conventions



1. _____ means that the business is distinguishable from its owners, which is a separate entity by itself.
 - A. Business entity concept
 - B. Business responsibility concept
 - C. Historical cost concept
 - D. Going concern concept

2. Business entity concept states that _____ .
 - A. owners can record personal expenses in the books of the company
 - B. owners can transfer the company's assets to themselves without paying for them
 - C. owners cannot record the company's assets as their own
 - D. owners cannot claim the profit derived from the operation of the business

3. Under business entity concept, which of the following statements are correct?
 - (1) Assets owned by an owner and his family are not recorded as assets of his firm.
 - (2) If an owner takes some assets of his business for personal use, it should be treated as drawings.
 - (3) An owner and his firm should have separate sets of accounting records.
 - A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)

4. Which of the following is the definition of historical cost concept?
 - A. Assets should be valued at the original costs of purchase.
 - B. Assets should be valued at the current market prices.
 - C. Assets should be valued at the lower of original prices and current market prices.
 - D. Assets should be valued at the higher of original prices and current market prices.

5. Which of the following is the underlying reason for adopting historical cost concept?
 - A. The historical cost method is the only way to record the value of assets.
 - B. It is difficult to measure the market values of the assets.
 - C. The data in financial statements are more updated.
 - D. It is more objective to record the assets at their original prices.

6. _____ assumes that the company will continue its operation in the foreseeable future.
- A. Business entity concept
 - B. Accrual concept
 - C. Historical cost concept
 - D. Going concern concept
7. When the going concern concept does not hold, which of the following concepts will no longer be valid?
- (1) business entity concept
 - (2) accrual concept
 - (3) historical cost concept
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)
8. When a business is going to close down, assets should be valued at _____ .
- A. historical costs
 - B. current market values
 - C. net book values
 - D. list prices
9. Which of the following descriptions about a firm are correct under the going concern concept?
- (1) It is assumed to continue to operate in the foreseeable future.
 - (2) It has no intention to liquidate or reduce significantly the scale of operation.
 - (3) Assets are valued at their current market prices to the business.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)
10. Accrual concept states that revenues and expenses of the firm should be recorded on _____ instead of _____ .
- A. accrual basis cash basis
 - B. accrual basis credit basis
 - C. cash basis accrual basis
 - D. credit basis cash basis

11. ABC Company entered into a one-year tenancy contract from 1 March 2013 to 28 February 2014. The monthly rental was \$9,000. For the year ended 31 December 2013, ABC Company paid \$108,000 for the contract and recorded it as rental expenses. The net profit for the year ended 31 December 2013 was _____ .
- A. overestimated by \$90,000
 - B. overestimated by \$18,000
 - C. underestimated by \$90,000
 - D. underestimated by \$18,000
12. _____ means that the accounting practice should not be changed from period to period unless the existing accounting practice is no longer appropriate.
- A. Business entity concept
 - B. Accrual concept
 - C. Consistency concept
 - D. Going concern concept
13. Suppose a company purchased a car three years ago at the price of \$30,000 and its market value has now increased to \$50,000. An accountant recorded the car in the financial statements at the price of \$50,000. Which of the following accounting principles has been violated?
- A. business entity concept
 - B. historical cost concept
 - C. accrual concept
 - D. going concern concept
14. Suppose an owner recorded his own electricity bill in his company's financial statements and settled it by the company's bank account. Which of the following accounting principles has been violated?
- A. consistency concept
 - B. historical cost concept
 - C. accrual concept
 - D. business entity concept
15. Suppose a company changed its depreciation method every year so that it could save the amount for the tax payable to the government. Which of the following accounting principles has been violated?
- A. consistency concept
 - B. historical cost concept
 - C. accrual concept
 - D. business entity concept

16. Suppose a company recorded an expense when it was paid, but the expense was incurred one year before the payment date. Which of the following accounting principles has been violated?
- consistency concept
 - historical cost concept
 - accrual concept
 - business entity concept
17. Under the consistency principle, _____ .
- the same method should be used to record the same type of transactions in a firm
 - the same method should be used to record the same type of transactions in different companies
 - the same method should be used to record different types of transactions in a firm
 - the same method should be used to record all types of transactions in a firm
18. An owner bought a piece of office equipment with a list price of \$5,000 for the company and 20% trade discount was given. He paid the purchase invoice by a personal cheque. Which of the following are the correct entries for this transaction?
- | | <u>Debit entry</u> | | <u>Credit entry</u> | |
|----|--------------------------|--|---------------------|--|
| A. | Office equipment \$5,000 | | Bank \$5,000 | |
| B. | Office equipment \$5,000 | | Capital \$5,000 | |
| C. | Office equipment \$4,000 | | Bank \$4,000 | |
| D. | Office equipment \$4,000 | | Capital \$4,000 | |
19. The financial year of BOBO Limited ends on 31 December each year. On 30 May 20X4, BOBO Limited received an annual service fee of \$600,000 from a customer for a service commencing on 1 June. On 31 December 20X4, _____ .
- \$250,000 should be treated as unearned revenues
 - \$300,000 should be treated as unearned revenues
 - \$600,000 should be treated as unearned revenues
 - \$600,000 should be treated as revenues for the current financial year

Based on the following information, answer Questions 20 to 21.

Peter purchased new premises with a list price of \$250,000 at 31 January 20X3 and a 20% trade discount was given. Its market value on that date was \$300,000. Due to poor management, Peter needed to close down his business on 28 February 20X3. The market value of the premises on the same date was \$180,000.

20. What was the valuation of the premises as at 31 January 20X3?
- \$300,000
 - \$250,000
 - \$200,000
 - \$180,000

21. What was the valuation of the premises as at 28 February 20X3?

- A. \$300,000
- B. \$250,000
- C. \$200,000
- D. \$180,000

22. The owner of a firm, Vivian, bought a motor car that is worth \$85,000 for her husband with a firm's cheque. Which of the following are the correct double entries for this transaction?

	<u>Debit entry</u>		<u>Credit entry</u>
A.	Motor van \$85,000	Capital	\$85,000
B.	Drawings \$85,000	Bank	\$85,000
C.	Motor van \$85,000	Bank	\$85,000
D.	Drawings \$85,000	Capital	\$85,000

23. At the beginning of the financial year, IU Limited paid a 3-year insurance premium of \$72,000. At the end of the financial year, _____ .

- A. \$72,000 should be treated as expenses
- B. \$72,000 should be treated as prepaid expenses
- C. \$24,000 should be treated as expenses
- D. \$24,000 should be treated as prepaid expenses

24. Suppose a fixture was purchased two years ago at the price of \$1,000 and the current market value is \$2,000. The amount recorded in non-current assets account should be _____ .

- A. \$1,000 according to the historical cost concept
- B. \$1,000 as it is a lower value
- C. \$2,000 as the current market price refers to the value of the fixture at that moment
- D. \$2,000 as it is a higher value

25. Which of the following violate(s) the respective accounting principle?

	<u>Situation</u>	<u>Principle violated</u>
(1)	change the depreciation method for equipment to show a desirable value of net profit	consistency concept
(2)	record the repayment of obligations of company with owner's savings as an injection of additional capital	business entity concept
(3)	record the value of a computer at the net amount after the deduction of trade discount from the list price	historical cost principle

- A. (1) only
- B. (2) only
- C. (1) and (2) only
- D. (2) and (3) only

26. Jack Company rents a new office and the lease term is from 1 January 20X6 to 31 December 20X6. For the year ended 31 December 20X5, Jack Company pays rent for three months. Based on the _____, Jack Company should record this transaction as expenses for the year _____.
- | | | | |
|----|-----------------------|-------|------|
| A. | consistency principle | ..... | 20X6 |
| B. | consistency principle | ..... | 20X5 |
| C. | accrual concept | ..... | 20X6 |
| D. | accrual concept | ..... | 20X5 |
27. Linda Company bought a machine on 9 June 20X7 and \$200,000 was paid on the same day. Its list price was \$300,000 and the trade discount was \$10,000. As at 30 June 20X7, the market price was \$250,000. The company had no intention to cease its operations at that time. On the statement of financial position as at 30 June 20X7, what should be the amount of the machine?
- | | |
|----|-----------|
| A. | \$200,000 |
| B. | \$250,000 |
| C. | \$290,000 |
| D. | \$300,000 |
28. Bobo Company will rent a warehouse from World Company from 1 May 20X7 to 30 April 20X9. On 1 April 20X7, Bobo Company paid \$360,000. It included a cleaning fee of \$10,000, two months' rent, and a rental deposit amounting to three months' rent. What should be the related rental expense recorded on the income statement for the year ended 31 March 20X8?
- | | |
|----|-----------|
| A. | \$770,000 |
| B. | \$792,000 |
| C. | \$840,000 |
| D. | \$980,000 |
29. As at 31 December 20X7, the amount of inventory and quick assets are \$22,500 and \$55,000 respectively. The quick ratio is 2.5 : 1. The amount of working capital is _____.
- | | |
|----|----------|
| A. | \$22,000 |
| B. | \$55,500 |
| C. | \$68,000 |
| D. | \$99,500 |

30. Which of the following correctly matches the situation and the accounting concept violated?

	<u>Situation</u>	<u>Accounting concept violated</u>
A.	Mr. Chan bought a diamond ring for her wife at the price of \$85,000. The market price of the ring is \$90,000. He recorded in the company's book as \$90,000.	historical cost concept
B.	XYZ Company decided not to provide depreciation on office equipment to boost the net profit.	consistency concept
C.	Mr. Lau is the owner of two companies. He decided to combine the books of the two companies as it is more convenient for him to manage the two companies.	business entity concept
D.	Billy paid insurance expense for 15 months for the company. The whole amount was entered as insurance expense in the financial statements.	going concern assumption

31. John was a sole proprietor running a small business. He bought a motor van with a list price of \$66,000 and received a discount amounting to \$8,000 in 20X7. John then went bankrupt on 1 April 20X8 and he decided to close the business. The market value of the motor van on the same date was \$38,000.

According to the _____, the value of the motor van as at 1 April 20X8 was _____.

A.	historical cost concept	.....	\$66,000
B.	historical cost concept	.....	\$58,000
C.	going concern assumption	.....	\$58,000
D.	going concern assumption	.....	\$38,000