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Direttori: Sergio Pellegrino e Giovanni Valcarenghi

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Elements of Financial Statements

di **Enrico Zappa, Justin Rainey**

Five phrases have been removed from the text below. Choose the correct phrase for each space (1-5) from the phrases (A-G). There is one phrase that you will not need.

1.17 *Elements of financial statements* are the basic categories of items portrayed therein in order to meet the objective of financial statements. Two types of elements are those that (1) _______ and those that describe changes in economic resources, obligations, and equity over a period of time. Notes to financial statements, which are useful for the purpose of clarification or further explanation of the items in financial statements, although an integral part of financial statements, are not considered to be an element.

1.18 *Net income* is the residual amount after expenses and losses are deducted from revenues and gains. Net income generally includes (2) _____________, except those that result from equity contributions and distributions.

Assets

1.19 *Assets* are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained.

1.20 Assets have three essential characteristics:

a. They embody a future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash flows.

b. The entity can control access to the benefit.

c. (3)_______________________________________.

1.21 It is not essential for control of access to the benefit to be legally enforceable for a resource to be an asset, provided the entity can control its use by other means.

1.22 A close association exists between incurring expenditures and generating assets, but the two do not necessarily coincide. Therefore, when an entity incurs an expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly, the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and, thus, becoming a candidate for recognition in the statement of financial position. For example, (4)____.

Liabilities

1.23 *Liabilities* are obligations of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services, or other yielding of economic benefits in the future.

1.24 Liabilities have three essential characteristics:

a. They embody a duty or responsibility to others that entails settlement by future transfer or use of assets, provision of services, or other yielding of economic benefits, at a specified or determinable date, on occurrence of a specified event, or on demand.

b. The duty or responsibility obligates the entity, leaving it little or no discretion to avoid it.

c. (5) ____________________________.

1.25 Liabilities do not have to be legally enforceable, provided that they otherwise meet the definition of liabilities; they can be based on equitable or constructive obligations. A constructive obligation is (6) ____________________ , as opposed to a contractually-based obligation.

(A) items that have been donated to the entity may satisfy the definition of an asset

(B) one that can be inferred from the facts in a particular situation

(C) describe the economic resources, obligations, and equity of an entity at a point in time

(D) the transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred

(E) the transaction or event obligating the entity has already occurred

(F) the item has an appropriate basis of measurement, and a reasonable estimate can be made of the amount involved

(G) all transactions and events increasing or decreasing the equity of the entity

Source: Adapted from Canadian Institute of Chartered Accountants (CICA) Handbook, 2012

Answers

1C; 2G; 3D; 4A; 5E; 6B

F is not used