

What is the Consistency Principle?

Worksheet

The consistency principle states that once a company adopts an accounting method (e.g., FIFO for inventory or straight-line depreciation), it must keep using that method in future periods unless a change is justified and clearly disclosed.

Questions

1. What does the consistency principle require of a company?

- A) Use the cheapest method available
- B) Use the same accounting method period to period unless justified and disclosed
- C) Change methods every year
- D) Use different methods for the same item each quarter

2. A company switches inventory methods without disclosing why. This is a violation of:

- A) The realization principle
- B) The consistency principle
- C) The going concern assumption
- D) The cost principle

3. Which of these is allowed under the consistency principle?

- A) Switching methods every quarter to lower taxes
- B) Changing a depreciation method with disclosure and justification
- C) Never disclosing any accounting policy
- D) Using two different methods for the same asset class in the same year

4. Why is the consistency principle important for investors?

- A) It maximizes reported profit
- B) It makes year-to-year comparisons meaningful
- C) It reduces taxes
- D) It eliminates the need for audits

5. A company has used straight-line depreciation for 5 years. This year management switches to double-declining balance to reduce taxable income, without disclosure. Is this consistent with the consistency principle?

6. A retailer has always used FIFO for inventory. Rising prices this year would make LIFO more tax-favorable. Can it just switch?

7. A company changes its estimate of a machine's useful life from 10 to 8 years because of new usage data. Does this violate consistency?

8. Define: What does the consistency principle require?

9. Define: Why does consistency matter to investors?

10. Define: Can a company ever change accounting methods?

Answer Key

1. B) Use the same accounting method period to period unless justified and disclosed - Consistency requires the same method over time unless a disclosed, justified change occurs.
2. B) The consistency principle - Undisclosed, unjustified method switches violate the consistency principle.
3. B) Changing a depreciation method with disclosure and justification - Changes are allowed if justified and disclosed, including their financial impact.
4. B) It makes year-to-year comparisons meaningful - Consistent methods keep financial statements comparable across periods.
5. The consistency principle requires the same method period to period unless a change is justified. An undisclosed switch made purely to lower income violates the principle - the change must be disclosed and justified, and prior statements may need restatement.
6. It may switch only for a valid business reason (not just tax savings), and must disclose the change and its effect on the financial statements in the notes. An unexplained switch would break comparability and violate the consistency principle.
7. This is a change in accounting estimate (not a change in method), applied prospectively. It does not violate the consistency principle as long as it is disclosed and based on genuine new information.
8. A company must use the same accounting methods period to period unless a change is justified and disclosed.
9. It makes financial statements comparable across years, so trends and ratios are meaningful.
10. Yes, but only for a valid reason, with disclosure of the change and its financial effect.

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