Intermediate Accounting 17th edition Kieso Solutions Manual

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CHAPTER 1

Financial Accounting and Accounting Standards

ASSIGNMENT CLASSIFICATION TABLE (By Topic)

Topics		Questions	Concepts for Analysis
1.	Subject matter of accounting.	1	4
2.	Environment of accounting.	2, 3, 21	6, 7
3.	Role of principles, objectives, standards, and accounting theory.	4, 5, 6, 7	1, 2, 3, 5
4.	Historical development of GAAP.	8, 9, 10, 11	8
5.	Authoritative pronouncements and rule-making bodies.	12, 13, 14, 15, 16, 17, 18, 19, 20	3, 9, 11, 12, 14
6.	Role of pressure groups.	21, 22, 23, 24, 25, 26	10, 16, 17
7.	Ethical issues.	28	13, 15

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ASSIGNMENT CLASSIFICATION TABLE (By Learning Objective)

Learning Objectives	Questions	Cases
1. Understand the financial reporting environment.	1, 2, 3, 4, 5, 6, 7	CA1.2, CA1.3, CA1.4, CA1.5, CA1.6, CA1.7, CA1.9
2. Identify the major policy-setting bodies and their role in the standard-setting process.	8, 9, 10, 11, 13, 14, 15, 16, 18, 19	CA1.1, CA1.2, CA1.3, CA1.7, CA1.8, CA1.9, CA1.10, CA1.11, CA1.12, CA1.14
3. Explain the meaning of generally accepted accounting principles (GAAP) and the role of the codification for GAAP.	12, 14, 18, 19, 20, 21	CA1.2, CA1.3, CA1.7, CA1.8, CA1.12
4. Describe major challenges in the financial reporting environment.	16, 17, 21, 22, 23, 24, 25, 26, 27, 28	CA1.6, CA1.10, CA1.11, CA1.13, CA1.15, CA1.16, CA1.17

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ASSIGNMENT CHARACTERISTICS TABLE

Item	Description	Level of Difficulty	Time (minutes)
CA1.1	FASB and standard-setting.	Simple	15–20
CA1.2	GAAP and standard-setting.	Simple	15–20
CA1.3	Financial reporting and accounting standards.	Simple	15–20
CA1.4	Financial accounting.	Simple	15–20
CA1.5	Objective of financial reporting.	Moderate	20–25
CA1.6	Accounting numbers and the environment.	Simple	10–15
CA1.7	Need for GAAP.	Simple	15–20
CA1.8	AICPA's role in rule-making.	Simple	20–25
CA1.9	FASB role in rule-making.	Simple	20–25
CA1.10	Politicization of GAAP.	Complex	30–40
CA1.11	Models for setting GAAP.	Simple	15–20
CA1.12	GAAP terminology.	Moderate	30–40
CA1.13	Rule-making Issues.	Complex	20–25
CA1.14	Securities and Exchange Commission.	Moderate	30–40
CA1.15	Financial reporting pressures.	Moderate	25–35
CA1.16	Economic consequences.	Moderate	25–35
CA1.17	GAAP and economic consequences.	Moderate	25–35

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ANSWERS TO QUESTIONS

1. Financial accounting measures, classifies, and summarizes in report form those activities and that information which relate to the enterprise as a whole for use by parties both internal and external to a business enterprise. Managerial accounting also measures, classifies, and summarizes in report form enterprise activities, but the communication is for the use of internal, managerial parties, and relates more to subsystems of the entity. Managerial accounting is management decision oriented and directed more toward product line, division, and profit center reporting.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

2. Financial statements generally refer to the four basic financial statements: balance sheet, income statement, statement of cash flows, and statement of changes in owners' or stockholders' equity. Financial reporting is a broader concept; it includes the basic financial statements and any other means of communicating financial and economic data to interested external parties. Examples of financial reporting other than financial statements are annual reports, prospectuses, reports filed with the government, news releases, management forecasts or plans, and descriptions of an enterprise's social or environmental impact.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

3. If a company's financial performance is measured accurately, fairly, and on a timely basis, the right managers and companies are able to attract investment capital. To provide unreliable and irrelevant information leads to poor capital allocation which adversely affects the securities market.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

4. The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in decisions about providing resources to the entity through equity investments and loans or other forms of credit. Information that is decision-useful to capital providers (investors) may also be useful to other users of financial reporting who are not investors.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC:: None

5. Investors are interested in financial reporting because it provides information that is useful for making decisions (referred to as the decision-usefulness approach). When making these decisions, investors are interested in assessing the company's (1) ability to generate net cash inflows and (2) management's ability to protect and enhance the capital providers' investments. Financial reporting should therefore help investors assess the amounts, timing, and uncertainty of prospective cash inflows from dividends or interest, and the proceeds from the sale, redemption, or maturity of securities or loans. In order for investors to make these assessments, the economic resources of an enterprise, the claims to those resources, and the changes in them must be understood.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

6. A common set of standards applied by all businesses and entities should produce financial statements which are reasonably comparable. Without a common set of standards, each enterprise could, and would, develop its own theory structure and set of practices, resulting in noncomparability among enterprises.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

7. General-purpose financial statements are not likely to satisfy the specific needs of all interested parties. Since the needs of interested parties such as creditors, managers, owners, governmental agencies, and financial analysts vary considerably, it is unlikely that one set of financial statements is equally appropriate for these varied uses.

LO: 1, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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8. The SEC has the power to prescribe, in whatever detail it desires, the accounting practices and principles to be employed by the companies that fall within its jurisdiction. Because the SEC receives audited financial statements from nearly all companies that issue securities to the public or are listed on the stock exchanges, it is greatly interested in the content, accuracy, and credibility of the statements. For many years, the SEC relied on the AICPA to regulate the profession and develop and enforce accounting principles. Lately, the SEC has assumed a more active role in the development of accounting standards, especially in the area of disclosure requirements. In December 1973, in ASR No. 150, the SEC said the FASB's statements would be presumed to carry substantial authoritative support and anything contrary to them to lack such support. It thereby supports the development of accounting principles in the private sector.

LO: 2, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

9. The Committee on Accounting Procedure was a special committee of the American Institute of CPAs that, between the years of 1939 and 1959, issued 51 **Accounting Research Bulletins** dealing with a wide variety of timely accounting problems. These bulletins provided solutions to immediate problems and narrowed the range of alternative practices. However, the Committee's problem-by-problem approach failed to provide a well-defined and well-structured body of accounting theory that was so badly needed. The Committee on Accounting Procedure was replaced in 1959 by the Accounting Principles Board.

LO: 2, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

10. The creation of the Accounting Principles Board was intended to advance the written expression of accounting principles, to determine appropriate practices, and to narrow the differences and inconsistencies in practice. To achieve its basic objectives, its mission was to develop an overall conceptual framework to assist in the resolution of problems as they became evident and to do substantive research on individual issues before pronouncements were issued.

LO: 2, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

11. **APB Opinions** were issued by the Accounting Principles Board during the years 1959 through 1973 and, unless superseded by FASB Statements, are recognized as accepted practice and constitute the requirements to be followed by all business enterprises. **Accounting Standards Updates** are pronouncements of the Financial Accounting Standards Board that are incorporated into the FASB codification and therefore represent the accounting profession's authoritative pronouncements on financial accounting and reporting practices. In addition, note that **Accounting Research Bulletins** were pronouncements on accounting practice issued by the Committee on Accounting Procedure between 1939 and 1959; since 1964 they have been recognized as accepted accounting practice unless superseded in part or in whole by an opinion of the APB or an FASB standard.

LO: 2, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

12. The explanation should note that generally accepted accounting principles or standards have "substantial authoritative support." They consist of accounting practices, procedures, concepts, and methods which are recognized by a large majority of practicing accountants as well as other members of the business and financial community. Bulletins issued by the Committee on Accounting Procedure, opinions rendered by the Accounting Principles Board, and statements issued by the Financial Accounting Standards Board constitute "substantial authoritative support."

LO: 3, Bloom: K, Difficulty: Simple, 5-10, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

13. It was believed that FASB Pronouncements would carry greater weight than APB Opinions because of significant differences between the FASB and the APB, namely, the FASB has: (1) a smaller membership, (2) full-time compensated members; (3) greater autonomy, (4) increased independence; and (5) broader representation than the APB.

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14. The technical staff of the FASB conducts research on an identified accounting topic and prepares a "preliminary view" that is released by the Board for public reaction. The Board analyzes and evaluates the public response to the preliminary view, deliberates on the issues, and issues an "exposure draft" for public comment. The preliminary view merely presents all facts and alternatives related to a specific topic or problem, whereas the exposure draft is a tentative "statement." After studying the public's reaction to the exposure draft, the Board may reevaluate its position, revise the draft, and vote on the issuance of a final statement.

LO: 2, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

15. Statements of financial accounting **standards** contained in Accounting Standards updates constitute generally accepted accounting principles and dictate acceptable financial accounting and reporting practices as promulgated by the FASB. The first standards statement was issued by the FASB in 1973.

Statements of financial accounting **concepts** do not establish generally accepted accounting principles. Rather, the concepts statements set forth fundamental objectives and concepts that the FASB intends to use as a basis for developing future standards. The concepts serve as guidelines in solving existing and emerging accounting problems in a consistent, sound manner. Both the standards statements and the concepts statements may develop through the same process from discussion memorandum, to exposure draft, to a final approved statement.

LO: 2, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

16. Rule 203 of the Code of Professional Conduct prohibits a member of the AICPA from expressing an opinion that financial statements conform with GAAP if those statements contain a material departure from an accounting principle promulgated by the FASB, or its predecessors, the APB and the CAP, unless the member can demonstrate that because of unusual circumstances the financial statements would otherwise have been misleading. Failure to follow Rule 203 can lead to the loss of a CPA's license to practice. This rule is extremely important because it requires auditors to follow FASB standards.

LO: 2, 4, Bloom: K, Difficulty: Simple, Time: 5-7, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

17. The chairman of the FASB was indicating that too much attention is put on the bottom line and not enough on the development of quality products. Managers should be less concerned with short-term results and be more concerned with the long-term results. In addition, short-term tax benefits often lead to long-term problems.

The second part of his comment relates to accountants being overly concerned with following a set of rules, so that if litigation ensues, they will be able to argue that they followed the rules exactly. The problem with this approach is that accountants want more and more rules with less reliance on professional judgment. Less professional judgment leads to inappropriate use of accounting procedures in difficult situations.

In the accountants' defense, recent legal decisions have imposed vast new liability on accountants. The concept of accountant's liability that has emerged in these cases is broad and expansive; the number of classes of people to whom the accountant is held responsible is almost limitless.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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18. The Emerging Issues Task Force often arrives at consensus conclusions on certain financial reporting issues. These consensus conclusions are then looked upon as GAAP by practitioners because the SEC has indicated that it will view consensus solutions as preferred accounting and will require persuasive justification for departing from them. Thus, at least for public companies which are subject to SEC oversight, consensus solutions developed by the Emerging Issues Task Force are followed unless subsequently overturned by the FASB. It should be noted that the FASB took greater direct ownership of GAAP established by the EITF by requiring that consensus positions be ratified by the FASB.

LO: 3, Bloom: K, Difficulty: Simple, Time: 5-7, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

19. The Financial Accounting Standards Board Accounting Standards Codification (Codification) is a compilation of all GAAP in one place. Its purpose is to integrate and synthesize existing GAAP and not to create new GAAP. It creates one level of GAAP which is considered authoritative. The FASB Codification Research Systems (CRS) is an online real-time data base which provides easy access to the Codification. The Codification and the related CRS provide a topically organized structure which is subdivided into topic, subtopics, sections, and paragraphs.

LO: 3, Bloom: K, Difficulty: Moderate, Time: 5-7, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

20. It is hoped that the Codification will help users to better understand what GAAP is. If this occurs, companies will be more likely to comply with GAAP and the time to research accounting issues will be substantially reduced. In addition, through the electronic web-based format, GAAP can be easily updated which will help users stay current.

LO: 3, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

21. The sources of pressure are innumerable, but the most intense and continuous pressure to change or influence accounting principles or standards come from individual companies, industry associations, governmental agencies, practicing accountants, academicians, professional accounting organizations, and public opinion.

LO: 3, Bloom: K, Difficulty: Simple, 5-10, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

22. Economic consequences means the impact of accounting reports on the wealth positions of issuers and users of financial information and the decision-making behavior resulting from that impact. In other words, accounting information impacts various users in many different ways which leads to wealth transfers among these various groups.

If politics plays an important role in the development of accounting rules, the rules will be subject to manipulation for the purpose of furthering whatever policy prevails at the moment. No matter how well intentioned the rule maker may be, if information is designed to indicate that investing in a particular enterprise involves less risk than it actually does, or is designed to encourage investment in a particular segment of the economy, financial reporting will suffer an irreplaceable loss of credibility.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

23. No one particular proposal is expected in answer to this question. The students' proposals, however, should be defensible relative to the following criteria:
(1) The method must be efficient, responsive, and expeditious.
(2) The method must be free of bias and be above or insulated from pressure groups.
(3) The method must command widespread support if it does not have legislative authority.
(4) The method must produce sound yet practical accounting principles or standards.
The students' proposals might take the form of alterations of the existing methodology, an accounting court (as proposed by Leonard Spacek), or governmental device.

LO: 4, Bloom: C, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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24. Concern exists about fraudulent financial reporting because it can undermine the entire financial reporting process. Failure to provide information to users that is accurate can lead to inappropriate allocations of resources in our economy. In addition, failure to detect massive fraud can lead to additional governmental oversight of the accounting profession.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

25. The expectations gap is the difference between what people think accountants should be doing and what accountants think they can do. It is a difficult gap to close. The accounting profession recognizes it must play an important role in narrowing this gap. To meet the needs of society, the profession is continuing its efforts in developing accounting standards, such as numerous pronouncements issued by the FASB, to serve as guidelines for recording and processing business transactions in the changing economic environment.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

26. The following are some of the key provisions of the Sarbanes-Oxley Act:

- Establishes an oversight board for accounting practices. The Public Company Accounting Oversight Board (PCAOB) has oversight and enforcement authority and establishes auditing, quality control, and independence standards and rules.
- Implements stronger independence rules for auditors. Audit partners, for example, are required to rotate every five years and auditors are prohibited from offering certain types of consulting services to corporate clients.
- Requires CEOs and CFOs to personally certify that financial statements and disclosures are accurate and complete and requires CEOs and CFOs to forfeit bonuses and profits when there is an accounting restatement.
- Requires audit committees to be comprised of independent members and members with financial expertise.
- Requires codes of ethics for senior financial officers.

In addition, Section 404 of the Sarbanes-Oxley Act requires public companies to attest to the effectiveness of their internal controls over financial reporting.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

27. Some major challenges facing the accounting profession relate to the following items:

Nonfinancial measurement—how to report significant key performance measurements such as customer satisfaction indexes, backlog information and reject rates on goods purchased.
Forward-looking information—how to report more future oriented information.
Soft assets—how to report on intangible assets, such as market know-how, market dominance, and well-trained employees.
Timeliness—how to report more real-time information.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

28. Accountants must perceive the moral dimensions of some situations because GAAP does not define or cover all specific features that are to be reported in financial statements. In these instances accountants must choose among alternatives. These accounting choices influence whether particular stakeholders may be harmed or benefited. Moral decision-making involves awareness of potential harm or benefit and taking responsibility for the choices.

LO: 4, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Ethics, Communication, AICPA BB: Professional Demeanor, AICPA FC: Reporting, AICPA PC: Communication

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TIME AND PURPOSE OF CONCEPTS FOR ANALYSIS

CA 1.1 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to answer questions about FASB and standard setting.

CA 1.2 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to answer questions about GAAP and standard setting.

CA 1.3 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to answer questions about financial reporting and accounting standards topics.

CA 1.4 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to distinguish between financial accounting and managerial accounting, identify major financial statements, and differentiate financial statements and financial reporting.

CA 1.5 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to explain the basic objective of financial reporting.

CA 1.6 (Time 10–15 minutes)
Purpose—to provide the student with an opportunity to describe how reported accounting numbers might affect an individual's perceptions and actions.

CA 1.7 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to evaluate the viewpoint of removing mandatory accounting rules and allowing each company to voluntarily disclose the information it desired.

CA 1.8 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to explain the evolution of accounting rule-making organizations and the role of the AICPA in the rule making environment.

CA 1.9 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to identify the sponsoring organization of the FASB, the method by which the FASB arrives at a decision, and the types and the purposes of documents issued by the FASB.

CA 1.10 (Time 30–40 minutes)
Purpose—to provide the student with an opportunity to focus on the types of organizations involved in the rule making process, what impact accounting has on the environment, and the environment's influence on accounting.

CA 1.11 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to focus on what type of rule-making environment exists in the United States. In addition, this CA explores why user groups are interested in the nature of GAAP and why some groups wish to issue their own rules.

CA 1.12 (Time 30–40 minutes)
Purpose—to provide the student with an opportunity to identify and define acronyms appearing in the first chapter. Some are self-evident, others are not so.

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Time and Purpose of Concepts for Analysis (Continued)

CA 1.13 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to consider the ethical dimensions of implementation of a new accounting pronouncement.

CA 1.14 (Time 30–40 minutes)
Purpose—to provide the student with an assignment that explores the role and function of the Securities and Exchange Commission.

CA 1.15 (Time 25–35 minutes)
Purpose—to provide the student with a writing assignment concerning the ethical issues related to meeting earnings targets.

CA 1.16 (Time 25–35 minutes)
Purpose—to provide the student with the opportunity to discuss the role of Congress in accounting rule-making.

CA 1.17 (Time 25–35 minutes)
Purpose—to provide the student with an opportunity to comment on a letter sent by business executives to the FASB and Congress on the accounting for derivatives.

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SOLUTIONS TO CONCEPTS FOR ANALYSIS

CA 1.1

1. True
2. False. Any company claiming compliance with GAAP must comply with all standards and interpretations, including disclosure requirements.
3. True
4. False. In establishing financial accounting standards, the FASB relies on two basic premises: (1) the FASB should be responsive to the needs and viewpoints of the entire economic community, not just the public accounting profession, and (2) it should operate in full view of the public through a "due process" system that gives interested people ample opportunities to make their view known.

LO: 2, Bloom: K, Difficulty: Simple, Time: 15-20, AACSB: AICPA BB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

CA 1.2

1. False. In addition to providing decision-useful information about future cash flows, management also is accountable to investors for the custody and safekeeping of the company's economic resources and for their efficient and profitable use; however, this is not considered an objective.
2. False. The objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.
3. False. The FASB follows the same due process procedures for interpretations and standards.
4. True

LO: 1, 2, Bloom: K, Difficulty: Simple, Time: 15-20, AACSB: AICPA BB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

CA 1.3

1. (d)
2. (d)
3. (d)
4. (a)
5. (a)
6. (b)
7. (d)
8. (b)

LO: 1, 2, 3, Bloom: K, Difficulty: Simple, Time: 15-20, AACSB: AICPA BB: None, AICPA BB: None, AICPA FC: Reporting, AICPA PC: None

CA 1.4

(a) Financial accounting is the process that culminates in the preparation of financial reports relative to the enterprise as a whole for use by parties both internal and external to the enterprise. In contrast, managerial accounting is the process of identification, measurement, accumulation, analysis, preparation, interpretation, and communication of financial information used by the management to plan, evaluate, and control within an organization and to assure appropriate use of, and accountability for, its resources.

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CA 1.4 (Continued)

(b) The financial statements most frequently provided are the balance sheet, the income statement, the statement of cash flows, and the statement of changes in owners' or stockholders' equity.

(c) Financial statements are the principal means through which financial information is communicated to those outside an enterprise. As indicated in (b), there are four major financial statements. However, some financial information is better provided, or can be provided only, by means of financial reporting other than formal financial statements. Financial reporting (other than financial statements and related notes) may take various forms. Examples include the company president's letter or supplementary schedules in the corporate annual reports, prospectuses, reports filed with government agencies, news releases, management's forecasts, and descriptions of an enterprise's social or environmental impact.

LO: 1, Bloom: K, Difficulty: Simple, Time: 15-20, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.5

(a) In accordance with **Statement of Financial Accounting Concepts No. 1,** "Objectives of Financial Reporting by Business Enterprises," the objectives of financial reporting are to provide information to investors, creditors, and others

1. that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence,
2. to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise, and
3. about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

(b) **Statement of Financial Accounting Concepts No. 1** establishes standards to meet the information needs of large groups of external users such as investors, creditors, and their representatives. Although the level of sophistication related to business and financial accounting matters varies both within and between these user groups, users are expected to possess a reasonable understanding of accounting concepts, financial statements, and business and economic activities and are expected to be willing to study and interpret the information with reasonable diligence.

LO: 1, Bloom: K, Difficulty: Moderate, Time: 20-25, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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CA 1.6

Accounting numbers affect investing decisions. Investors, for example, use the financial statements of different companies to enhance their understanding of each company's financial strength and operating results. Because these statements follow generally accepted accounting principles, investors can make meaningful comparisons of different financial statements to assist their investment decisions.

Accounting numbers also influence creditors' decisions. A commercial bank usually looks into a company's financial statements and past credit history before deciding whether to grant a loan and in what amount. The financial statements provide a fair picture of the company's financial strength (for example, short-term liquidity and long-term solvency) and operating performance for the current period and over a period of time. The information is essential for the bank to ensure that the loan is safe and sound.

LO: 1, 4, Bloom: C, Difficulty: Simple, Time: 10-15, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.7

It is not appropriate to abandon mandatory accounting rules and allow each company to voluntarily disclose the type of information it considers important. Without a coherent body of accounting theory and standards, each accountant or enterprise would have to develop its own theory structure and set of practices, and readers of financial statements would have to familiarize themselves with every company's peculiar accounting and reporting practices. As a result, it would be almost impossible to prepare statements that could be compared.

In addition, voluntary disclosure may not be an efficient way of disseminating information. A company is likely to disclose less information if it has the discretion to do so. Thus, the company can reduce its cost of assembling and disseminating information. However, an investor wishing additional information has to pay to receive additional information desired. Different investors may be interested in different types of information. Since the company may not be equipped to provide the requested information, it would have to spend additional resources to fulfill such needs; or the company may refuse to furnish such information if it is too costly to do so. As a result, investors may not get the desired information or they may have to pay a significant amount of money for it. Furthermore, redundancy in gathering and distributing information occurs when different investors ask for the same information at different points in time. To the society as a whole, this would not be an efficient way of utilizing resources.

LO: 1, 2, 3, Bloom: AN, Difficulty: Simple, Time: 15-20, AACSB: Reflective Thinking, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.8

(a) One of the committees that the AICPA established prior to the establishment of the FASB was the Committee on Accounting Procedures (CAP). The CAP, during its existence from 1939 to 1959, issued 51 Accounting Research Bulletins (ARB). In 1959, the AICPA created the Accounting Principles Board (APB) to replace the CAP. Before being replaced by the FASB, the APB released 31 official pronouncements, called APB Opinions.

(b) Although the ARBs issued by the CAP helped to narrow the range of alternative practices to some extent, the CAP's problem-by-problem approach failed to provide the well-defined, structured body of accounting principles that was both needed and desired. As a result, the CAP was replaced by the APB.

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CA 1.8 (Continued)

The APB had more authority and responsibility than did the CAP. Unfortunately, the APB was beleaguered throughout its 14-year existence. It came under fire early, charged with lack of productivity and failing to act promptly to correct alleged accounting abuses. The APB also met a lot of industry and CPA firm opposition and occasional governmental interference when tackling numerous complicated accounting issues. In fear of governmental rule making, the accounting profession investigated the ineffectiveness of the APB and replaced it with the FASB.

Learning from prior experiences, the FASB has several significant differences from the APB. The FASB has: (1) smaller membership, (2) full-time, compensated membership, (3) greater autonomy, (4) increased independence, and (5) broader representation. In addition, the FASB has its own research staff and relies on the expertise of various task force groups formed for various projects. These features form the bases for the expectations of success and support from the public. In addition, the due process taken by the FASB in establishing financial accounting standards gives interested persons ample opportunity to make their views known. Thus, the FASB is responsive to the needs and viewpoints of the entire economic community, not just the public accounting profession.

(c) The AICPA supplements the FASB's efforts in the present standard-setting environment. Their issue papers, which are prepared by the Financial Reporting Executive Committee (FinREC) formerly the Accounting Standards Executive Committee (AcSEC), identify current financial reporting problems for specific industries and present alternative treatments of the issue. These papers provide the FASB with an early warning device to insure timely issuance of FASB standards. In situations where the FASB avoids the subject of an issue paper, FinREC may issue a Statement of Position to provide guidance for the reporting issue. FinREC also issues Practice Bulletins which indicate how the AICPA believes a given transaction should be reported.

Recently, the role of the AICPA in standard-setting has diminished. The FASB and the AICPA agreed, that after a transition period, the AICPA and FinREC no longer issues authoritative accounting guidance for public companies.

LO: 2, Bloom: K, Difficulty: Simple, Time: 20-25, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.9

(a) The Financial Accounting Foundation (FAF) is the sponsoring organization of the FASB. The FAF selects the members of the FASB and its Advisory Council, funds their activities, and generally oversees the FASB's activities.

The FASB follows a due process in establishing a typical FASB Statement of Financial Accounting Standards. The following steps are usually taken: (1) A topic or project is identified and placed on the Board's agenda. (2) A task force of experts from various sectors is assembled to define problems, issues, and alternatives related to the topic. (3) Research and analysis are conducted by the FASB technical staff. (4) A preliminary views document is drafted and released. (5) A public hearing is often held, usually 60 days after the release of the preliminary views. (6) The Board analyzes and evaluates the public response. (7) The Board deliberates on the issues and prepares an exposure draft for release. (8) After a 30-day (minimum) exposure period for public comment, the Board evaluates all of the responses received. (9) A committee studies the exposure draft in relation to the public responses, reevaluates its position, and revises the draft if necessary. (10) The full Board gives the revised draft final consideration and votes on issuance of a Standards Statement. The passage of a new accounting standard in the form of an FASB Statement requires the support of four of the seven Board members, before it is incorporated in the codification.

(b) The FASB issues two major types of pronouncements: Accounting Standards Updates (ASUs) and Concepts Statements. ASUs issued by the FASB are considered GAAP.

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CA 1.9 (Continued)

ASU's may be comprised of major standards projects, EITF consensus, or interpretations. Regardless of nature, if approved by the FASB in an ASU, then the guidance is considered GAAP.

The Statements of Financial Accounting Concepts (SFAC) help the FASB to avoid the "problem-by-problem approach." These statements set forth fundamental objectives and concepts that the Board will use in developing future standards of financial accounting and reporting. They are intended to form a cohesive set of interrelated concepts, a body of theory or a conceptual framework, that will serve as tools for solving existing and emerging problems in a consistent, sound manner.

In addition, the FASB's Emerging Issues Task Force (EITF) issues statements to provide guidance on how to account for new and unusual financial transactions that have the potential for creating diversity in reporting practices. The EITF identifies controversial accounting problems as they arise and determines whether they can be quickly resolved or whether the FASB should become involved in solving them. In essence, it becomes a "problem filter" for the FASB. Thus, the FASB is able to work on more pervasive long-term problems, while the EITF deals with short-term emerging issues.

LO: 2, Bloom: K, Difficulty: Simple, Time: 20-25, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.10

(a) **CAP.** The Committee on Accounting Procedure, CAP, which was in existence from 1939 to 1959, was an outgrowth of AICPA committees which were in existence during the period 1933 to 1938. The committee was formed in direct response to the criticism received by the accounting profession during the financial crisis of 1929 and the years thereafter. The authorization to issue pronouncements on matters of accounting principles and procedures was based on the belief that the AICPA had the responsibility to establish practices that would become generally accepted by the profession and by corporate management.

As a general rule, the CAP directed its attention, almost entirely, to resolving specific accounting problems and topics rather than to the development of generally accepted accounting principles. The committee voted on the acceptance of specific Accounting Research Bulletins published by the committee. A two-thirds majority was required to issue a particular research bulletin. The CAP did not have the authority to require acceptance of the issued bulletins by the general membership of the AICPA, but rather received its authority only upon general acceptance of the pronouncement by the members. That is, the bulletins set forth normative accounting procedures that "should be" followed by the accounting profession, but were not "required" to be followed.

In 1964, well after the demise of the CAP, the Council of the AICPA adopted recommendations that departures from effective CAP Bulletins should be disclosed in financial statements or in audit reports of members of the AICPA. The demise of the CAP could probably be traced to four distinct factors: (1) the narrow nature of the subjects covered by the bulletins issued by the CAP, (2) the lack of any theoretical groundwork in establishing the procedures presented in the bulletins, (3) the lack of any real authority by the CAP in prescribing adherence to the procedures described by the bulletins, and (4) the lack of any formal representation on the CAP of interest groups such as corporate managers, governmental agencies, and security analysts.

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APB. The objectives of the APB were formulated mainly to correct the deficiencies of the CAP as described above. The APB was thus charged with the responsibility of developing written expression of generally accepted accounting principles through consideration of the research done by other members of the AICPA in preparing Accounting Research Studies. The committee was in turn given substantial authoritative standing in that all opinions of the APB were to constitute substantial authoritative support for generally accepted accounting principles. If an individual member of the AICPA decided that a principle or procedure outside of the official pronouncements of the APB had substantial authoritative support, the member had to disclose the departure from the official APB opinion in the financial statements of the firm in question.

The membership of the committee comprising the APB was also extended to include representation from industry, government, and academe. The opinions were also designed to include minority dissents by members of the board. Exposure drafts of the proposed opinions were readily distributed.

The demise of the APB occurred primarily because the purposes for which it was created were not being accomplished. Broad generally accepted accounting principles were not being developed. The research studies supposedly being undertaken in support of subsequent opinions to be expressed by the APB were often ignored. The committee in essence became a simple extension of the original CAP in that only very specific problem areas were being addressed. Interest groups outside of the accounting profession questioned the appropriateness and desirability of having the AICPA directly responsible for the establishment of GAAP. Politicization of the establishment of GAAP had become a reality because of the far-reaching effects involved in the questions being resolved.

FASB. The formal organization of the FASB represents an attempt to vest the responsibility of establishing GAAP in an organization representing the diverse interest groups affected by the use of GAAP. The FASB is independent of the AICPA. It is independent, in fact, of any private or governmental organization. Individual CPAs, firms of CPAs, accounting educators, and representatives of private industry will now have an opportunity to make known their views to the FASB through their membership on the Board. Independence is facilitated through the funding of the organization and payment of the members of the Board. Full-time members are paid by the organization and the organization itself is funded solely through contributions. Thus, no one interest group has a vested interest in the FASB.

Conclusion. The evolution of the current FASB certainly does represent "increasing politicization of accounting standards setting." Many of the efforts extended by the AICPA can be directly attributed to the desire to satisfy the interests of many groups within our society. The FASB represents, perhaps, just another step in this evolutionary process.

(b) Arguments for politicization of the accounting rule-making process:

1. Accounting depends in large part on public confidence for its success. Consequently, the critical issues are not solely technical, so all those having a bona fide interest in the output of accounting should have some influence on that output.
2. There are numerous conflicts between the various interest groups. In the face of this, compromise is necessary, particularly since the critical issues in accounting are value judgments, not the type which are solvable, as we have traditionally assumed, using deterministic models. Only in this way (reasonable compromise) will the financial community have confidence in the fairness and objectivity of accounting rule-making.
3. Over the years, accountants have been unable to establish, on the basis of technical accounting elements, rules which would bring about the desired uniformity and acceptability. This inability itself indicates rule-setting is primarily consensual in nature.

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CA 1.10 (Continued)

4. The public accounting profession, through bodies such as the Accounting Principles Board, made rules which business enterprises and individuals "had" to follow. For many years, these businesses and individuals had little say as to what the rules would be, in spite of the fact that their economic well-being was influenced to a substantial degree by those rules. It is only natural that they would try to influence or control the factors that determine their economic well-being.

(c) Arguments against the politicization of the accounting rule-making process:
1. Many accountants feel that accounting is primarily technical in nature. Consequently, they feel that substantive, basic research by objective, independent and fair-minded researchers ultimately will result in the best solutions to critical issues, such as the concepts of income and capital, even if it is accepted that there is not necessarily a single "right" solution.
2. Even if it is accepted that there are no "absolute truths" as far as critical issues are concerned, many feel that professional accountants, taking into account the diverse interests of the various groups using accounting information, are in the best position, because of their independence, education, training, and objectivity, to decide what generally accepted accounting principles ought to be.
3. The complex situations that arise in the business world require that trained accountants develop the appropriate accounting principles.
4. The use of consensus to develop accounting principles would decrease the professional status of the accountant.
5. This approach would lead to "lobbying" by various parties to influence the establishment of accounting principles.

LO: 4, Bloom: E, Difficulty: Complex, Time: 30-40, AACSB: Analytic, Communication, Ethics, AICPA BB: Professional Demeanor, AICPA FC: Reporting, AICPA PC: Communication

CA 1.11

(a) The public/private mixed approach is the way rules are established in the United States. In many respects, the FASB is a quasi-governmental agency in that its pronouncements are required to be followed because the SEC has provided support for this approach. The SEC has the ultimate power to establish GAAP but has chosen to permit the private sector to develop these rules. By accepting the standards established by the FASB as authoritative, it has granted much power to the FASB.

(b) Publicly reported accounting numbers influence the distribution of scarce resources. Resources are channeled where needed at returns commensurate with perceived risk. Thus, reported accounting numbers have economic effects in that resources are transferred among entities and individuals as a consequence of these numbers. It is not surprising then that individuals affected by these numbers will be extremely interested in any proposed changes in the financial reporting environment.

(c) The Accounting Standards Executive Committee (AcSEC of the AICPA), among other groups, has presented a potential challenge to the exclusive right of the FASB to establish accounting principles. Also, Congress has been attempting to legislate certain accounting practices, particularly to help struggling industries.

Some possible reasons why other groups might wish to establish GAAP are:
1. As indicated in the previous answer, these rules have economic effects and therefore certain groups would prefer to make their own rules to ensure that they receive just treatment.
2. Some believe the FASB does not act quickly to resolve accounting matters, either because it is not that interested in the subject area or because it lacks the resources to do so.

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CA 1.11 (Continued)

3. Some argue that the FASB does not have the competence to legislate GAAP in certain areas. For example, many have argued that the FASB should not legislate GAAP for not-for-profit enterprises because the problems are unique and not well understood by the FASB.

LO: 2, Bloom: C, Difficulty: Simple, Time: 15-20, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.12

(a) **AICPA.** American Institute of Certified Public Accountants. The national organization of practicing certified public accountants.

(b) **CAP.** Committee on Accounting Procedure. A committee of practicing CPAs which issued 51 Accounting Research Bulletins between 1939 and 1959 and is a predecessor of the FASB.

(c) **EITF.** Emerging Issues Task Force. A sub-division of the FASB, which provides implementation guidance to reduce diversity in practice in a timely basis. To become GAAP, EITF consensues must be approved by the FASB.

(d) **APB.** Accounting Principles Board. A committee of public accountants, industry accountants and academicians which issued 31 Opinions between 1959 and 1973. The APB replaced the CAP and was itself replaced by the FASB. Its opinions, unless superseded, remain a primary source of GAAP.

(e) **FAF.** Financial Accounting Foundation. An organization whose purpose is to select members of the FASB and its Advisory Councils, fund their activities, and exercise general oversight.

(f) **FASAC.** Financial Accounting Standards Advisory Council. An organization whose purpose is to consult with the FASB on issues, project priorities, and select task forces.

(g) **GAAP.** Generally Aaccepted Accounting Principles. A common set of standards, principles, and procedures which have substantial authoritative support and have been accepted as appropriate because of universal application.

(h) **CPA.** Certified Public Accountant. An accountant who has fulfilled certain education and experience requirements and passed a rigorous examination. Most CPAs offer auditing, tax, and management consulting services to the general public.

(i) **FASB.** Financial Accounting Standards Board. The primary body which currently establishes and improves financial accounting and reporting standards for the guidance of issuers, auditors, users, and others.

(j) **SEC.** Securities and Exchange Commission. An independent regulatory agency of the United States government which administers the Securities Acts of 1933 and 1934 and other acts.

(k) **IASB.** International Accounting Standards Board. An international group, formed in 2001 (a predecessor body was formed in 1973), that is actively developing and issuing accounting standards that will have international appeal and hopefully support.

LO: 3, Bloom: K, Difficulty: Moderate, Time: 30-40, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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CA 1.13

(a) Inclusion or omission of information that materially affects net income harms particular stakeholders. Accountants must recognize that their decision to implement (or delay) reporting requirements will have immediate consequences for some stakeholders.

(b) Yes. Because the FASB rule results in a fairer representation, it should be implemented as soon as possible—regardless of its impact on net income. SEC Staff Bulletin No. 74 (December 30, 1987) requires a statement as to what the expected impact of the standard will be.

(c) The accountant's responsibility is to provide financial statements that present fairly the financial condition of the company. By advocating early implementation, Weller fulfills this task.

(d) Potential lenders and investors, who read the financial statements and rely on their fair representation of the financial condition of the company, have the most to gain by early implementation. A stockholder who is considering the sale of stock may be harmed by early implementation that lowers net income (and may lower the value of the stock).

LO: 3, Bloom: K, Difficulty: Complex, Time: 20-25, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.14

(a) The Securities and Exchange Commission (SEC) is an independent federal agency that receives its authority from federal legislation enacted by Congress. The Securities and Exchange Act of 1934 created the SEC.

(b) As a result of the Securities and Exchange Act of 1934, the SEC has legal authority relative to accounting practices. The U.S. Congress has given the SEC broad regulatory power to control accounting principles and procedures in order to fulfill its goal of full and fair disclosure.

(c) There is no direct relationship as the SEC was created by Congress and the Financial Accounting Standards Board (FASB) was created by the private sector. However, the SEC historically has followed a policy of relying on the private sector to establish financial accounting and reporting standards known as generally accepted accounting principles (GAAP). The SEC does not necessarily agree with all of the pronouncements of the FASB. In cases of unresolved differences, the SEC rules take precedence over FASB rules for companies within SEC jurisdiction.

LO: 2, Bloom: K, Difficulty: Moderate, Time: 30-40, AACSB: Communication, AICPA BB: AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.15

(a) The ethical issue in this case relates to making questionable entries to meet expected earnings forecasts. As indicated in this chapter, businesses' concentration on "maximizing the bottom line," "facing the challenges of competition," and "stressing short-term results" places accountants in an environment of conflict and pressure.

(b) Given that Normand has pleaded guilty, he certainly acted improperly. Doing the right thing, making the right decision, is not always easy. Right is not always obvious, and the pressures to "bend the rules," "to play the game," "to just ignore it" can be considerable.

(c) No doubt, Normand was in a difficult position. He was concerned that if he failed to go along, it would affect his job performance negatively or that he might be terminated. These job pressures, time pressures, peer pressures often lead individuals astray. Can it happen to you? One individual noted that at a seminar on ethics sponsored by the CMA Society of Southern California, attendees were asked if they had ever been pressured to make questionable entries. This individual noted that to the best of his recollection, everybody raised a hand, and more than one had eventually chosen to resign.

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CA 1.15 (Continued)

(d) Major stakeholders were: (1) Troy Normand, (2) present and potential stockholders and creditors of WorldCom, (3) employees, and (4) family. Recognize that WorldCom was at that time the largest bankruptcy in United States history, so many individuals are affected.

LO: 4, Bloom: AN, Difficulty: Moderate, Time: 25-30, AACSB:Ethics, Analytic, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

CA 1.16

(a) Considering the economic consequences of GAAP, it is not surprising that special interest groups become vocal and critical (some supporting, some opposing) when rules are being formulated. The FASB's derivative accounting pronouncement is no exception. Many from the banking industry, for example, criticized the rule as too complex and leading to unnecessary earnings volatility. They also indicated that the proposal may discourage prudent risk management activities and in some cases could present misleading financial information.

As a result, Congress is often approached to put pressure on the FASB to change its rulings. In the stock option controversy, industry was quite effective in going to Congress to force the FASB to change its conclusions. In the derivative controversy, Rep. Richard Baker introduced a bill which would force the SEC to formally approve each standard issued by the FASB. Not only would this process delay adoption, but could lead to additional politicalization of the rule-making process. Dingell commented that Congress should stay out of the rule-making process and defended the FASB's approach to establishing GAAP.

(b) Attempting to set GAAP by a political process will probably lead to the following consequences:
(a) Too many alternatives.
(b) Lack of clarity that will lead to inconsistent application.
(c) Lack of disclosure that reduces transparency.
(d) Not comprehensive in scope.

Without an independent process, GAAP will be based on political compromise. A classic illustration is what happened in the savings and loan industry. Applying generally accepted accounting principles to the S&L industry would have forced regulators to restrict activities of many S&Ls. Unfortunately, accounting principles were overridden by regulatory rules and the resulting lack of transparency masked the problems. William Siedman, former FDIC Chairman noted later that it was "the worst mistake in the history of government."

Another indication of the problem of government intervention is shown in the accounting standards used by some countries around the world. Completeness and transparency of information needed by investors and creditors is not available in order to meet or achieve other objectives.

LO: 4, Bloom: C, Difficulty: Moderate, Time: 25-30, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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CA 1.17

(a) The "due process" system involves the following:
1. Identifying topics and placing them on the Board's agenda.
2. Research and analysis is conducted and preliminary views of pros and cons issued.
3. A public hearing is often held.
4. Board evaluates research and public responses and issues exposure draft.
5. Board evaluates responses and changes exposure draft, if necessary. Final statement is then issued.

(b) Economic consequences mean the impact of accounting reports on the wealth positions of issuers and users of financial information and the decision-making behavior resulting from that impact.

(c) Economic consequences indicated in the letter are: (1) concerns related to the potential impact on the capital markets, (2) the weakening of companies' ability to manage risk, and (3) the adverse control implications of implementing costly and complex new rules imposed at the same time as other major initiatives, including the Year 2000 issues and a single European currency.

(d) The principal point of this letter is to delay the finalization of the derivatives standard. As indicated in the letter, the authors of this letter urge the FASB to expose its new proposal for public comment, following the established due process procedures that are essential to acceptance of its standards and providing sufficient time for affected parties to understand and assess the new approach. (Authors note: The FASB indicated in a follow-up letter that all due process procedures had been followed and all affected parties had more than ample time to comment. In addition, the FASB issued a follow-up standard, which delayed the effective date of the standard, in part to give companies more time to develop the information systems needed for implementation of the standard).

(e) The reason why the letter was sent to Congress was to put additional pressure on the FASB to delay or drop the issuance of a rule on derivatives. Unfortunately, in too many cases, when the business community does not like the answer proposed by the FASB, it resorts to lobbying members of Congress. The lobbying efforts usually involve developing some type of legislation that will negate the rule. In some cases, efforts involve challenging the FASB's authority to develop rules in certain areas with additional Congressional oversight.

LO: 4, Bloom: E, Difficulty: Moderate, Time: 25-30, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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FINANCIAL REPORTING PROBLEM

(a) The key organizations involved in rule making in the U.S. are the AICPA, FASB, and SEC. See also (c).

(b) Different authoritative literature pertaining to methods recording accounting transactions exists today. Some authoritative literature has received more support from the profession than other literature. The literature that has substantial authoritative support is the one most supported by the profession and should be followed when recording accounting transactions. These standards and procedures are called generally accepted accounting principles (GAAP).

With implementation of the Codification, what qualifies as authoritative is any literature contained in the Codification. The Codification changes the way GAAP is documented, presented, and updated. It creates one level of GAAP which is considered authoritative. All other accounting literature is considered non-authoritative.

What happens if the Codification does not cover a certain type of transaction or event? In this case, other accounting literature should be considered which includes FASB Concepts Statements, international financial reporting standards and other professional literature.

(c) Rule-making in the U.S. has evolved through the work of the following organizations:

1. **American Institute of Certified Public Accountants (AICPA)—it is the national professional organization of practicing Certified Public Accountants (CPAs). Outgrowths of the AICPA have been the Committee on Accounting Procedure (CAP) which issued Accounting Research Bulletins and the Accounting Principles Board (APB) whose major purposes were to advance written expression of accounting principles, determine appropriate practices, and narrow the areas of difference and inconsistency in practice.**
2. **Financial Accounting Standards Board (FASB)—the mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, which includes issuers, auditors, and users of the financial information.**

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3. Securities and Exchange Commission (SEC)—the SEC is an independent regulatory agency of the United States government which administers the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act, and several other acts. The SEC has broad power to prescribe the accounting practices and standards to be employed by companies that fall within its jurisdiction.

(d) The SEC and the AICPA have been the authority for compliance with GAAP. The SEC has indicated that financial statements conforming to standards set by the FASB will be presumed to have authoritative support. The AICPA, in Rule 203 of the Code of Professional Ethics, requires that members prepare financial statements in accordance with GAAP. Failure to follow Rule 203 can lead to the loss of a CPA's license to practice.

LO: 2, 3, Bloom: K, Difficulty: Simple, Time: 20-25, AACSB: Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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SOLUTIONS TO CODIFICATION EXERCISES

CE1.1

The information at this link describes the elements offered in The FASB Accounting Standards Codification. As indicated, the website offers several resources to enhance your working knowledge of the Codification and the Codification Research System. This page includes links to help pages which describe specific functions and features of the Codification. Links to frequently asked questions, the FASB Learning Guide, and the Notice to Constituents are also available on this page.

Help pages

FAQ

Learning Guide

About the Codification—Notice of Constituents

LO: 3, Bloom: K, Difficulty: Simple, Time: 5-10, AACSB: Communication, Technology, AICPA BB: Technology, AICPA FC: Research, Reporting, Technology, AICPA PC: Communication

CE1.2

The following information is provided at the Providing Feedback link:

The Codification includes a feature which can be used to submit content-related feedback or general, system-related comments. The feedback system is not designed for comments on proposed Accounting Standards Updates.

Content-related feedback

As a registered user of the FASB Accounting Standards Codification Research System website, you are able and are encouraged to provide feedback, at the paragraph level, to the FASB about any content-related matters. For specific information about the Codification and the feedback process, please read the Notice to Constituents.

To provide content-related feedback:

Click the Submit feedback button beneath the paragraph for which you want to provide feedback. Enter or copy/paste your comments in the text box. Note that formatting (lists, bold, etc.) is not retained and there is a 4,000 character limit on feedback submissions.

Click SUBMIT. Your comments are sent to the FASB and reviewed by FASB staff. You can also submit multiple comments for any given paragraph, if, for example, you determine that more information would be useful to the FASB staff.

General feedback

Click here to provide general feedback on the Codification in general, the Codification Research System website, and other system-related items that are not content specific.

LO: 3, Bloom: K, Difficulty: Simple, Time: 10-15, AACSB: Communication, Technology, AICPA BB: Technology, AICPA FC: Research, Reporting, Technology, AICPA PC: Communication

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CE1.3

The “What’s New” page provides links to Codification content that has been recently issued. During the verification phase, updates may result from either the issuance of Codification update instructions that accompany new Standards or from changes to the Codification due to incorporation of constituent feedback.

LO: 3, Bloom: K, Difficulty: Simple, Time: 5-10, AACSB: Communication, Technology, AICPA BB: Technology, AICPA FC: Research, Reporting, Technology, AICPA PC: Communication

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RESEARCH CASE

(a) CON 1, Par. 32. The objectives begin with a broad focus on information that is useful in investment and credit decisions; then narrow that focus to investors' and creditors' primary interest in the prospects of receiving cash from their investments in or loans to business enterprises and the relation of those prospects to the enterprise's prospects; and finally focus on information about an enterprise's economic resources, the claims to those resources, and changes in them, including measures of the enterprise's performance, that is useful in assessing the enterprise's cash flow prospects.

(b) CON 1, Par. 7. Financial reporting includes not only financial statements but also other means of communicating information that relates, directly or indirectly, to the information provided by the accounting system—that is, information about an enterprise's resources, obligations, earnings, etc. Management may communicate information to those outside an enterprise by means of financial reporting other than formal financial statements either because the information is required to be disclosed by authoritative pronouncement, regulatory rule, or custom or because management considers it useful to those outside the enterprise and discloses it voluntarily. Information communicated by means of financial reporting other than financial statements may take various forms and relate to various matters. Corporate annual reports, prospectuses, and annual reports filed with the Securities and Exchange Commission are common examples of reports that include financial statements, other financial information, and nonfinancial information. News releases, management's forecasts or other descriptions of its plans or expectations, and descriptions of an enterprise's social or environmental impact are examples of reports giving financial information other than financial statements or giving only nonfinancial information.

(c) CON 1, Par, 24 and 25: 24. Many people base economic decisions on their relationships to and knowledge about business enterprises and thus are potentially interested in the information provided by financial reporting. Among the potential users are owners, lenders, suppliers, potential investors and creditors, employees, management, directors, customers, financial analysts and advisors, brokers, underwriters, stock exchanges, lawyers, economists, taxing authorities, regulatory authorities,

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legislators, financial press and reporting agencies, labor unions, trade associations, business researchers, teachers and students, and the public. Members and potential members of some groups—such as owners, creditors, and employees—have or contemplate having direct economic interests in particular business enterprises. Managers and directors, who are charged with managing the enterprise in the interest of owners (paragraph 12), also have a direct interest. Members of other groups—such as financial analysts and advisors, regulatory authorities, and labor unions—have derived or indirect interests because they advise or represent those who have or contemplate having direct interests.

Potential users of financial information most directly concerned with a particular business enterprise are generally interested in its ability to generate favorable cash flows because their decisions relate to amounts, timing, and uncertainties of expected cash flows. To investors, lenders, suppliers, and employees, a business enterprise is a source of cash in the form of dividends or interest and perhaps appreciated market prices, repayment of borrowing, payment for goods or services, or salaries or wages. They invest cash, goods, or services in an enterprise and expect to obtain sufficient cash in return to make the investment worthwhile. They are directly concerned with the ability of the enterprise to generate favorable cash flows and may also be concerned with how the market's perception of that ability affects the relative prices of its securities. To customers, a business enterprise is a source of goods or services, but only by obtaining sufficient cash to pay for the resources it uses and to meet its other obligations can the enterprise provide those goods or services. To managers, the cash flows of a business enterprise are a significant part of their management responsibilities, including their accountability to directors and owners. Many, if not most, of their decisions have cash flow consequences for the enterprise. Thus, investors, creditors, employees, customers, and managers significantly share a common interest in an enterprise's ability to generate favorable cash flows. Other potential users of financial information share the same interest, derived from investors, creditors, employees, customers, or managers whom they advise or represent or derived from an interest in how those groups (and especially stockholders) are faring.

LO: 1, Bloom: AN, Difficulty: Simple, Time: 25-30, AACSB: Analytic, Communication, AICPA BB: Technology, AICPA FC: Research, Reporting, Technology, AICPA PC: Communication

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IFRS CONCEPTS AND APPLICATION

IFRS 1.1

The two organizations involved in international standard-setting are IOSCO (International Organization of Securities Commissions) and the IASB (International Accounting Standards Board.) The IOSCO does not set accounting standards, but ensures that the global markets can operate in an efficient and effective manner. Conversely, the IASB's mission is to develop a single set of high quality, understandable and international financial reporting standards (IFRSs) for general purpose financial statements.

LO: 5, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

IFRS 1.2

The standards issued by these organizations are sometimes principles-based, rules-based, tax-oriented, or business-based. In other words, they often differ in concept and objective.

LO: 5, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

IFRS 1.3

A single set of high quality accounting standards ensures adequate comparability. Investors are able to make better investment decisions if they receive financial information from a U.S. company that is comparable to an international competitor.

LO: 5, Bloom: K, Difficulty: Simple, Time: 3-5, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

IFRS 1.4

The international standards must be of high quality and sufficiently comprehensive. To achieve this goal, the IASB and the FASB have set up an extensive work plan to achieve the objective of developing one set of world-class international standards. This work plan actually started in 2002, when an agreement was forged between the two Boards, where each acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting (referred to as the Norwalk Agreement).

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IFRS 1.4 (Continued)

At that meeting, the FASB and the IASB pledged to use their best efforts to (1) make their existing financial reporting standards fully compatible as soon as is practicable, and (2) coordinate their future work programs to ensure that once achieved, compatibility is maintained. This document was reinforced in 2006 when the parties issued a memorandum of understanding (MOU) which highlighted three principles:

- **Convergence of accounting standards can best be achieved through the development of high-quality common standards over time.**
- **Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead, a new common standard should be developed that improves the financial information reported to investors.**
- **Serving the needs of investors means that the Boards should seek convergence by replacing standards in need of improvement with jointly developed new standards.**

Subsequently, in 2009 the Boards agreed on a process to complete a number of major projects by 2011, including monthly joint meetings. As part of achieving this goal, it is critical that the process by which the standards are established be independent. And, it is necessary that the standards are maintained, and emerging accounting issues are dealt with efficiently.

The SEC directed its staff to develop and execute a plan ("Work Plan") to enhance both the understanding of the SEC's purpose and public transparency in this area. The SEC Work Plan addresses such areas as independence of standard-setting, investor understanding of IFRS, and auditor readiness. Based on the staff report issued in 2012, it does not appear that the SEC is ready to adopt IFRS any time soon. However, the SEC has encouraged the FASB and IASB to continue their convergence efforts.

In 2016, the SEC indicated that it will not switch to IFRS in the near future. As the SEC Chief Accountant noted: "I believe that for the foreseeable future, the independent standard setting process of the FASB and U.S. GAAP standards will be in the best interests of U.S. capital markets."

LO: 5, Bloom: K, Difficulty: Simple, 20-25, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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IFRS 1.5

(a) The International Accounting Standards Board is an independent, privately funded accounting standards setter based in London, UK. The Board is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the Board cooperates with national accounting standards setters to achieve convergence in accounting standards around the world.

(b) In summary, the following groups might gain most from convergence of financial reporting:

- **Investors, investment analysts and stockbrokers: to facilitate international comparisons for investment decisions.**
- **Credit grantors: for similar reasons to bullet point above.**
- **Multinational companies: as preparers, investors, appraisers of products or staff, and as movers of staff around the globe; also, as raisers of finance on international markets (this also applies to some companies that are not multinationals).**
- **Governments: as tax collectors and hosts of multinationals; also interested are securities markets regulators and governmental and nongovernmental rule makers.**

(c) The fundamental argument against convergence is that, to the extent that international differences in accounting practices result from underlying economic, legal, social, and other environmental factors, harmonization may not be justified. Different accounting has grown up to serve the different needs of different users; this might suggest that the existing accounting practice is "correct" for a given nation and should not be changed merely to simplify the work of multinational companies or auditors. There does seem to be strength in this point particularly for smaller companies with no significant multinational activities or connections. To foist upon a small private family company in Luxembourg lavish disclosure requirements and the need to report a "true and fair" view may be an expensive and unnecessary piece of convergence.

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IFRS1.5 (Continued)

The most obvious obstacle to harmonization is the sheer size and deep rootedness of the differences in accounting. These differences have grown up over the previous century because of differences in users, legal systems, and so on. Thus, the differences are structural rather than cosmetic, and require revolutionary action to remove them.

LO: 5, Bloom: K, Difficulty: Simple, Time: 15-20, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

IFRS 1.6

(a) "IFRS Framework OB2 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit."

(b) IFRS financial reports include note disclosures which will contain additional information relevant to the needs of users about items in the financial statements. In addition to these note disclosures IFRS Framework OB6 indicates: "However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks. Explanations with this additional pertinent information are often found in the Management Discussion and Analysis included in the annual report but not as part of audited financial statements and therefore not subject to accounting standards.

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IFRS1.6 (Continued)

(c) As indicated in the introduction to the IFRS framework, financial statements prepared to meet the objective of financial reporting meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information. In addition, financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the entity or whether to reappoint or replace the management. Although management is also a user of financial information as discussed in OB9 of the IFRS Framework, they are able to access the information internally rather than through general purpose financial statements.

LO: 5, Bloom: K, Difficulty: Simple, Time: 15-20, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

IFRS1.7

(a) Operating retail stores (clothing, home, and food).

(b) Operations are primarily in the UK, Belgium, Canada, China, Czech Republic, Estonia, France. Greece, Hong Kong, Hungary, India, Indonesia, Israel, Italy, Jersey, Kuwait, Latvia, Lithuania, Montenegro, Netherlands, Poland, Qatar, Republic of Ireland, Romania, Serbia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Switzerland, Thailand, Turkey, and The United States.

(c) Waterside House, 35 North Wharf Road, London W2 1NW.

(d) Pound.

LO: 5, Bloom: K, Difficulty: Simple, Time: 5-7, AACSB: Diversity, Communication, AICPA BB: None, AICPA FC: Reporting, AICPA PC: Communication

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1

Financial Accounting and Accounting Standards

CHAPTER LEARNING OBJECTIVES

1. Describe the financial reporting environment.
2. Identify the major policy-setting bodies and their role in the standards-setting process.
3. Explain the meaning of generally accepted accounting principles (GAAP) and the role of the Codification for GAAP.
4. Describe major challenges in the financial reporting environment.
*5. Compare GAAP and IFRS and their standard process setting.

CHAPTER REVIEW

1. Chapter 1 describes the environment that has influenced both the development and use of the financial accounting process. The chapter traces the development of financial accounting standards, focusing on the groups that have had or currently have the responsibility for developing such standards. Certain groups other than those with direct responsibility for developing financial accounting standards have significantly influenced the standard-setting process. These various pressure groups are also discussed in Chapter 1.

Financial Reporting Environment

2. (L.O. 1) The essential characteristics of accounting are (1) the identification, measurement, and communication of financial information about (2) economic entities to (3) interested parties. **Financial accounting** is the process that culminates in the preparation of financial reports on the enterprise for use by both internal and external parties.

3. **Financial statements** are the principal means through which a company communicates its financial information to those outside it. The financial statements most frequently provided are (1) the balance sheet, (2) the income statement, (3) the statement of cash flows, and (4) the statement of owners' or stockholders' equity. Note disclosures are an integral part of each financial statement. Other means of communication information that might not be included in the financial statements include the president's letter or supplementary schedules in the corporate annual report, prospectuses, reports filed with government agencies, news releases, management forecasts, and social or environmental impact statements.

4. Accounting is important for markets, free enterprise, and competition because it assists in providing information that leads to capital allocation. The better the information, the more effective the process of capital allocation and then the healthier the economy.

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* *Note: All asterisked (*) items relate to material contained in the Appendices to the chapter.*

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Objective of Financial Reporting

5. The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors. General-purpose financial statements provide financial reporting information to a wide variety of users.

6. The objective of financial reporting identifies investors and creditors as the primary users for general-purpose financial statements. As part of the objective of general-purpose financial reporting, an entity perspective is adopted. Companies are viewed as separate and distinct from their owners. When making decisions, investors are interested in assessing (1) the company's ability to generate net cash inflows and (2) management's ability to protect and enhance the capital providers' investments.

7. The accounting profession has developed a common set of standards and procedures known as **generally accepted accounting principles (GAAP).** These principles serve as a general guide to the accounting practitioner in accumulating and reporting the financial information of a business enterprise.

Securities and Exchange Commission (SEC)

8. (L.O. 2) After the stock market crash in 1929 and the Great Depression, there were calls for increased government regulation and supervision—especially financial institutions and the stock market. As a result, the federal government established the Securities and Exchange Commission (SEC) to help develop and standardize financial information presented to stockholders. The SEC is a federal agency and administers the Securities Exchange Act of 1934 and several other acts. Most companies that issue securities to the public or are listed on a stock exchange are required to file audited financial statements with the SEC. In addition, the SEC has broad powers to prescribe the accounting practices and standards to be employed by companies that fall within its jurisdiction.

9. At the time the SEC was created, it encouraged the creation of a private standards-setting body. As a result, accounting standards have developed in the private sector either through the American Institute of Certified Public Accountants (AICPA) or the Financial Accounting Standards Board (FASB). The SEC has affirmed its support for the FASB by indicating that financial statements conforming to standards set by the FASB will be presumed to have substantial authoritative support.

10. Over its history, the SEC's involvement in the development of accounting standards has varied. In some cases, the private sector has attempted to establish a standard, but the SEC has refused to accept it. In other cases, the SEC has prodded the private sector into taking quicker action on setting standards.

11. If the SEC believes that an accounting or disclosure irregularity exists regarding a company's financial statements, the SEC sends a deficiency letter to the company. If the company's response to the deficiency letter proves unsatisfactory, the SEC has the power to issue a "stop order," which prevents the registrant from issuing securities or trading securities on the exchanges. Criminal charges may also be brought by the Department of Justice.

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The AICPA and Development of Accounting Principles

12. At the urging of the SEC, the AICPA appointed the **Committee on Accounting Procedure (CAP)** in 1939. This group issued 51 **Accounting Research Bulletins (ARBs)** during the years 1939 to 1959.

13. In 1959, the AICPA created the **Accounting Principles Board (APB).** The major purposes of this group were (a) to advance the written expression of accounting principles, (b) to determine appropriate practices, and (c) to narrow the areas of difference and inconsistency in practice. Its pronouncements, known as **APB Opinions,** were intended to be based mainly on research studies and be supported by reason and analysis.

The FASB

14. Early in its existence the APB was criticized for lack of productivity and failing to act promptly, then it was criticized for overreacting to certain issues. A committee, known as the **Study Group on Establishment of Accounting Principles (Wheat Committee),** was set up to study the APB and recommend changes in its structure and operation. The result of the Study Group's findings was the demise of the APB and the creation of the **Financial Accounting Standards Board** (FASB) in 1973. The FASB represents the current rule-making body within the accounting profession.

15. The role of the AICPA in standard setting is now diminished, but has a Financial Reporting Executive Committee (FinREC), which is authorized to make public statements on behalf of the AICPA on financial reporting matters. FinREC also issues audit and accounting guides, which address particular areas in financial reporting. Furthermore, the AICPA has been the leader in developing auditing standards through its Auditing Standards Board—but the Sarbanes-Oxley Act now requires the Public Company Accounting Oversight Board to oversee the development of auditing standards. The AICPA continues to develop and grade the CPA examination.

16. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, which includes issuers, auditors, and users of financial information. The FASB differs from the predecessor APB in the following ways:

a. Smaller membership (7 versus 18 on the APB).
b. Full-time remunerated membership (APB members were unpaid and part-time).
c. Greater autonomy (APB was a senior committee of the AICPA).
d. Increased independence (FASB members must sever all ties with firms, companies, or institutions).
e. Broader representation (it is not necessary to be a CPA to be a member of the FASB).

Two basic premises of the FASB are that in establishing financial accounting standards: (a) it should be responsive to the needs and viewpoints of the entire economic community, not just the public accounting profession, and (b) it should operate in full view of the public through a "due process" system that gives interested persons ample opportunity to make their views known.

17. The FASB issues two major types of pronouncements:

1. Accounting Standards Updates.
2. Financial Accounting Concepts.

The FASB issues accounting pronouncements through **Accounting Standards Updates.** The updates amend the Accounting Standards Codification which represents the source of authoritative accounting standards, other than standards issued by the SEC.

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18. A second type of update is a consensus of the Emerging Issues Task Force (EITF) created in 1984 by the FASB. The EITF identifies controversial accounting problems as they arise.

19. (L.O. 3) Generally accepted accounting principles (GAAP) are those principles that have **substantial authoritative support.** Accounting principles that have substantial authoritative support are those found in FASB Standards, APB Opinions; and AICPA Research Bulletins (ARBs). If an accounting transaction is not covered in any of these documents, the accountant may look to other authoritative accounting literature for guidance.

20 The FSAB developed the Financial Accounting Standards Board Accounting Standards Codification ("the Codification") to provide in one place all the authoritative literature related to a particular topic. This will simplify user access to all authoritative U.S generally accepted accounting principles. The Financial Accounting Standards Board Codification Research System (CRS) is an online real-time database that provides easy access to the Codification.

21. Although accounting standards are developed by using careful logic and empirical findings, a certain amount of pressure and influence is brought to bear by groups interested in or affected by accounting standards. The FASB does not exist in a vacuum, and politics and special-interest pressures remain a part of the standard-setting process.

22. In 2002, along with establishing the PCAOB, the Sarbanes-Oxley Act implements stronger independence rules for auditors, requires CEOs and CFOs to personally certify that financial statements and disclosures are accurate and complete, requires audit committees to be comprised of independent members, and requires a code of ethics for senior financial officers. In addition, the Sarbanes-Oxley Act requires public companies to attest to the effectiveness of their internal controls over financial reporting.

23. Some of the issues facing financial reporting in the future are the following:
    a. **Nonfinancial measurements,** which include customer satisfaction indexes, backlog information, reject rates on goods purchased, as well as the results of companies' sustainability efforts.
    b. **Forward-looking information.**
    c. **Soft assets** of such intangibles as market dominance, expertize in supply chain management, and brand image.
    d. **Timeliness** including real-time financial statement information.
    e. **Understandability** of financial reports.

24. Most countries have recognized the need for more global standards. **The International Accounting Standards Board (IASB)** and U.S. rule-making bodies are working together to reconcile U.S. GAAP with the IASB International Financial Reporting Standards (IFRS). Throughout this studyguide, there will be a discussion on the differences between GAAP and IFRS.

25. In accounting ethical dilemmas are encountered frequently. The whole process of ethical sensitivity and selection among alternatives can be complicated by pressures that may take the form of time pressures, job pressures, client pressures, personal pressures, and peer pressures. Throughout the textbook, ethical considerations are presented to sensitize you to the type of situations you may encounter in your profession.

*IFRS Insights

*26. (L.O. 5) Most agree that there is a need for one set of international accounting standards because of multinational corporations, mergers and acquisitions, information technology, and financial markets. International standards are referred to as *International Financial Reporting*

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Standards (IFRS), developed by the International Accounting Standards Board (IASB). The textbook describes many of the differences between the IFRS and generally accepted accounting principles (GAAP).

*27. GAAP is more detailed or rules-based. IFRS tends to be simpler and more flexible in its accounting and disclosure requirements. Differences between GAAP and IFRS have developed because of different user needs in countries. In some countries, the primary users of financial statements are private investors; in others, the primary users are tax authorities and central government planners; and in the U.S. investors and creditors have driven accounting-standard formulation. The SEC allows foreign companies that trade shares in U.S. markets to file their IFRS financial statements without reconciliation to GAAP.

*28. The FASB and the IASB have been working diligently to (1) make their existing financial reporting standards fully compatible as soon as practicable, and (2) coordinate their future work programs to ensure that once achieved, compatibility is maintained. This process is referred to as convergence, and the Boards have made significant progress in developing high-quality converged standards.

GLOSSARY

Accounting Principles Board (APB).	An accounting rule-making board which provided official pronouncements, called APB Opinions, from 1959 through 1973.
Accounting Research Bulletins (ARBs).	Pronouncements issued by CAP dealing with a variety of timely accounting problems during the years 1939 to 1959.
Accounting Standards Updates.	These Updates amend the Accounting Standards Codification, which represents the source of authoritative accounting standards, other than standards issued by the SEC.
American Institute of Certified Public Accountants (AICPA).	The national professional organization of practicing Certified Public Accountants.
APB Opinions.	The APB's official pronouncements issued from 1959 through 1973 which were intended to be based mainly on research studies and be supported by reasons and analysis.
The Codification	Created by the FASB and provides in one place all the authoritative literature to a particular topic of GAAP.
Committee on Accounting Procedure (CAP).	An organization composed of practicing CPAs which issued Accounting Research Bulletins dealing with a variety of accounting problems during the years 1939 to 1959.
Emerging Issues Task Force (EITF).	Created by the FASB with the purpose of having members reach a consensus on how to account for new and unusual financial transactions that have the potential for creating differing financial reporting practices.

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Emerging Issues Task Force Statements.	Pronouncements issued by the EITF which examine emerging financial reporting issues and state how to account for new and unusual accounting transactions.
Financial Accounting Concepts.	A series of pronouncements issued by the FASB with the purpose of setting forth fundamental objectives and concepts that the FASB will use in developing future standards of financial accounting and reporting.
Financial Accounting Foundation.	The organization that selects the members of the FASB and the FASAC, funds their activities, and generally oversees the FASB's activities.
Financial Accounting Interpretations.	Pronouncements issued by the FASB which represent modifications or extensions of existing standards.
Financial Accounting Standards.	Pronouncements issued by the FASB which are considered generally accepted accounting principles.
Financial Accounting Standards Advisory Council (FASAC).	A council responsible for consulting with the FASB on both major policy and technical issues.
Financial Accounting Standards Board (FASB).	A seven member board created in 1973 which currently establishes and improves standards of financial accounting and reporting for the guidance and education of the public.
Financial Reporting Executive Committee (FinREC)	An agency of the AICPA authorized to make public statements on behalf of the AICPA on financial reporting matters.
Generally accepted accounting principles (GAAP).	A common set of standards and procedures adopted by the accounting profession.
Internal Controls	A system of checks and balances designed to prevent and detect fraud and errors.
International Accounting Standards Board (IASB)	Based in London, it produces the International Financial Reporting Standards (IFRS).
International Financial Reporting Standards (IFRS)	Standards created by the London-based International Accounting Standards Board (IASB) that along with GAAP are accepted for international use.
Public Company Accounting Oversight Board (PCAOB)	Established by the Sarbanes-Oxley Act of 2002 and has oversight and enforcement authority and establishes auditing, quality control, and independence standards and rules.
Sarbanes-Oxley Act of 2002	Passed by Congress in response to accounting scandals like Enron, Cendant, Sunbeam, Rite-Aid and WorldCom.
Securities and Exchange Commission (SEC).	An agency of the federal government that administers the Securities Exchange Act of 1934.

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CHAPTER OUTLINE

Fill in the outline presented below.

(L.O. 1) Financial Statements and Financial Reporting

Chapter Outline (*continued*)

Accounting and Capital Allocation

Objective of Financial Reporting

The Need to Develop Standards

(L.O. 2) Parties Involved in Standard-Setting

The Securities and Exchange Commission

The American Institute of Certified Public Accountants

The Financial Accounting Standards Board

Accounting Standards Updates.

Financial Accounting Concepts

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Emerging Issues Task Force Statements

(L.O. 3) Generally Accepted Accounting Principles

Chapter Outline (*continued*)

The Codification

Standard Setting in a Political Environment

Sarbanes-Oxley Act of 2002

Public Company Accounting Oversight Board

International Accounting Standards

The Challenges Facing Financial Reporting

Ethics in Financial Accounting

REVIEW QUESTIONS

TRUE-FALSE

Indicate whether each of the following is true (T) or false (F) in the space provided.

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_____ 1. (L.O. 1) The essential characteristics of accounting include identification and measurement.

_____ 2. (L.O. 1) Financial accounting is the process that culminates in the preparation of financial reports on an enterprise and that are used by both internal and external parties.

_____ 3. (L.O. 1) An effective process of capital allocation is not important to a healthy economy.

_____ 4. (L.O. 1) An entity perspective generally views companies as separate and distinct from the owners (present shareholders).

_____ 5. (L.O. 1) One of the objectives of financial reporting is to provide information that is useful in assessing cash flow prospects of the entity being reported on.

_____ 6. (L.O. 1) The accounting profession has attempted to develop a set of standards so each enterprise can develop their own standards.

_____ 7. (L.O. 2) The SEC has been the principal organization in the development of accounting standards.

_____ 8. (L.O. 2) The Securities and Exchange Commission (SEC) sets accounting standards for companies that do work for the government.

_____ 9. (L.O. 2) The Accounting Principles Board (APB) replaced the Committee on Accounting Procedure (CAP) and was designated as the AICPA's sole authority for public pronouncements on accounting principles.

_____ 10. (L.O. 2) The difference between Accounting Research Bulletins (ARBs) and Accounting Principles Board Opinions is that ARBs deal with accounting theory and the APB Opinions deal with accounting practice.

_____ 11. (L.O. 2) The major purpose of the APB during its 13-year existence was to develop a single set of accounting standards useful to all business entities.

_____ 12. (L.O. 2) The AICPA has had a diminished role in the Standard setting process after the passage of the Sarbanes-Oxley Act of 2002.

_____ 13. (L.O. 2) The Public Company Accounting Oversight Board (PCAOB) oversees the development of auditing standards.

_____ 14. (L.O. 2) The Accounting Principles Board (APB) was replaced in 1973 by the Financial Accounting Standards Board (FASB), which now is primarily responsible for setting accounting standards.

_____ 15. (L.O. 2) All those who serve on the FASB must be Certified Public Accountants.

_____ 16. (L.O. 2) The FASB issues accounting pronouncements through Accounting Standards Updates.

_____ 17. (L.O. 2) The purpose of the EITF is to reach a consensus on how to account for new and unusual financial transactions.

_____ 18. (L.O. 3) Generally accepted accounting principles (GAAP) are defined, in part, as those principles that have substantial authoritative support.

_____ 19. (L.O. 3) The Codification provides in one place all the authoritative literature related to a particular topic of GAAP.

_____ 20. (L.O. 3) The International Accounting Standards Board (IASB) has been replaced by the FASB as the rule-making body for world-wide GAAP.

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SOLUTIONS TO REVIEW QUESTIONS

TRUE-FALSE

1. (T)
2. (T)
3. (F) An effective process of capital allocation is critical to a healthy economy.
4. (T)
5. (T)
6. (F) The accounting profession has attempted to develop a set of standards that are generally accepted and universally practiced.
7. (F) The SEC has the mandate to establish accounting principles but has acted with remarkable restraint in the area of developing accounting standards. Generally, it has relied on the AICPA and FASB to regulate the accounting profession and develop and enforce accounting standards.
8. (F) The SEC is empowered to administer the 1933 and 1934 Securities Acts. The SEC was given broad powers to prescribe the accounting practices and standards to be employed by companies that issue securities to the public or are listed on a stock exchange.
9. (T)
10. (F) Both ARBs and APB Opinions represent authoritative pronouncements designed to establish principles of accounting. The major difference is that ARBs were issued by the Committee on Accounting Procedure (CAP) and APB Opinions were issued by the Accounting Principles Board.
11. (F) The major purposes of the APB were (a) to advance the written expression of accounting principles, (b) to determine appropriate practices, and (c) to narrow the areas of difference and inconsistency in practice.
12. (T)
13. (T)
14. (T)
15. (F) At the present time it is not necessary to be a CPA to be a member of the FASB.
16. (T)
17. (T)
18. (T)
19. (T)
20. (F) The IASB and U.S. accounting organizations are trying to work together to reconcile U.S. GAAP with IASB standards but are currently separate agencies.

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