Financial Reporting and Analysis 8th edition Revsine Solutions Manual

SKU: 9781260247848-SOLUTIONS

Financial Reporting and Analysis (8th Ed.)
Chapter 1 Solutions
The Economic and Institutional Setting for Financial Reporting
Problems

Problems

P1-1. Demand for accounting information (LO 1-1)

Requirement 1:

a) ***Existing shareholders*** use financial accounting information as part of their ongoing investment decisions—should more shares of common or preferred stock be purchased, should some shares be sold, or should current holdings be maintained? Financial statements help investors assess the expected risk and return from owning a company's common and preferred stock. They are especially useful for investors who adopt a "fundamental analysis" approach.

Shareholders also use financial accounting information to decide how to vote on corporate matters like who should be elected to the board of directors, whether a particular management compensation plan should be approved, and if the company should merge with or acquire another company. Acting on behalf of shareholders, the Board of Directors hires and fires the company's top executives. Financial statement information helps shareholders and the board assess the performance of company executives. Dismissals of top executives often occur following a period of deteriorating financial performance.

b) Financial statement information helps ***prospective*** (***potential) investors*** identify stocks consistent with their preferences for risk, return, dividend yield, and liquidity. Here too, financial statements are especially useful for those investors that adopt a "fundamental approach."

c) ***Financial analysts*** demand accounting information because it is essential for their jobs. Equity (stock) and credit (debt) analysts provide a wide range of services ranging from producing summary reports and recommendations about companies and their securities to actively managing portfolios for investors that prefer to delegate buying and selling decisions to professionals. Analysts rely on information about the economy, individual industries, and particular companies when providing these services. As a group, analysts constitute probably the largest single source of demand for financial accounting information—without it, their jobs would be difficult, if not impossible, to do effectively.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education..

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

d) ***Managers*** demand financial accounting information to help them carry out their responsibilities to shareholders. Financial accounting information is used by managers to assess the profitability and health of individual business units and the company as a whole. Their compensation often depends on financial statement numbers like earnings per share, return on equity, return on capital employed, sales growth, and so on. Managers often use a competitor's financial statements to benchmark profit performance, cost structures, financial health, capabilities, and strategies.

e) ***Current employees*** demand financial accounting information to monitor payouts from profit-sharing plans and employee stock ownership plans (ESOPs). Employees also demand financial accounting information to gauge a company's long-term viability and the likelihood of continued employment, as well as payouts under company-sponsored pension and health-care programs. Unionized employees have other reasons to demand financial statements, and those are described in Requirement 2 which follows.

f) ***Lenders*** use financial accounting information to help determine the principal amount, interest rate, term, and collateral required on loans they make. Loan agreements often contain covenants that require a company to maintain minimum levels of various accounting ratios. Because covenant compliance is measured by accounting ratios, lenders demand financial accounting information so they can monitor the borrower's compliance with loan terms.

g) ***Suppliers*** demand financial accounting information about current and potential customers to determine whether to grant credit, and on what terms. The incentive to monitor a customer's financial condition and operating performance does not end after the initial credit decision. Suppliers monitor the financial condition of their customers to ensure that they are paid for the products, materials, and services they sell.

h) ***Debt-rating agencies*** like Moody's or Standard & Poor's help lenders and investors assess the default risk of debt securities offered for sale. Rating agencies need financial accounting information to evaluate the level and volatility of the company's expected future cash flows.

i) ***Taxing authorities*** (one type of government regulatory agency) use financial accounting information as a basis for establishing tax policies. Companies or industries that appear to be earning "excessive" profits may be targeted for special taxes or higher tax rates. Keep in mind, however, that taxing authorities in the United States and many other countries are allowed to set their own accounting rules. These tax accounting rules, and not GAAP, determine a company's taxable income.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

Other government agencies are often customers of the company. In this setting, financial information can serve to help resolve contractual disputes between the company and its customer (the agency) including claims that the company is earning excessive profits. Financial accounting information can also be used to determine if the company is financially strong enough to deliver the ordered goods and services.

Financial accounting information is also used in rate-making deliberations and monitoring of regulated monopolies such as public utilities.

Requirement 2:
Student responses will vary, but examples are shareholder activist groups (CalPERS), labor unions, and customers.

- Shareholder activist groups demand financial accounting information to help determine how well the company's current management team is doing, and whether the managers are being paid appropriately.

- Labor unions demand financial accounting information to help formulate or improve their bargaining positions with employer companies. Union negotiators may use financial statements showing sustained or improved profitability as evidence that employee wages and benefits should be increased.

- Customers demand financial accounting information to help determine if the company will be able to deliver the product on a timely basis and provide product support after delivery.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-2. Incentives for voluntary disclosure (LO 1-3)

Requirement 1:

a) Companies compete with one another for financial capital in debt and equity markets. They want to obtain financing at the lowest possible cost. If investors are unsure about the "quality" of a company's debt and equity securities—the risks and returns of investment—they will demand a lower price (higher rate of return) than would otherwise be the case. Companies have incentives to voluntarily provide information that allows investors and lenders to assess the expected risk and return of each security. Failing to do so means lenders may charge a higher rate of interest for the added informational risk, and stock investors will give the company less cash for its common or preferred stock.

b) Companies compete with one another for talented managers and employees. Information about a company's past financial performance, its current health, and its prospects is useful to current and potential employees who are interested in knowing about long-term employment opportunities, present and future salary and benefit levels, and advancement opportunities at the company. To attract the best talent, companies have incentives to provide financial information that allows prospective managers and employees to assess the risk and potential rewards of employment.

c) Companies and their managers also compete with one another in the "market for corporate control." Here companies make offers to buy or merge with other companies. Managers of companies that are the target of a *friendly* merger or tender offer—a deal they want done—have incentives to disclose information that raises the bid price. Examples include forecasts of increased sales and earnings growth. Managers of companies that are the target of *unfriendly* (hostile) offers—deals they don't want done—have incentives to disclose information that shows the company is best left in the hands of current management. Hostile bidders often put a different spin on the same financial information, arguing that it shows just how poorly current management has run the company.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

Requirement 2:
Student responses will vary, but here are some examples:

- Competitive forces from within the industry (i.e., other firms in the industry are voluntarily disclosing information about order backlogs, customer turnover, or other key performance indicators).

- Demands by financial analysts for expanded or increased disclosure by the firm.

- Demands by shareholder activist groups such as CalPERS.

- Demands by debt rating agencies such as Moody's and Standard & Poor's.

- Pressure from governmental regulatory agencies such as the Securities and Exchange Commission. Firms may believe that disclosing certain information voluntarily may prevent the Securities and Exchange Commission from mandating more detailed disclosures at a later date.

- Demands from institutional investors (e.g., mutual funds, pension funds, insurance companies, etc.) that hold the company's securities.

Requirement 3:
The following examples are press release items that could be disclosed voluntarily: forecasts of current quarter or annual earnings; forecasts of current quarter or annual sales; forecasts of earnings growth for the next 3 to 5 years; forecasts of sales growth for the next 3 to 5 years; capital expenditure plans or budgets; research and development plans or budgets;

new product developments; patent applications and awards; changes in top management; details of corporate restructurings, spin-offs, reorganizations, plans to discontinue various divisions and/or lines-of-business; announcements of corporate acquisitions and/or divestitures; announcements of new debt and/or equity offerings; and announcements of short-term financing arrangements such as lines of credit. Other student responses are possible.

The advantage of releasing such information in press releases is that the news is made available to external parties on a far more timely basis than if disclosure occurred in quarterly or annual financial statements. Press releases also give management an opportunity to help shape how the facts are interpreted.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-3. Costs of disclosure (LO 1-3)

Requirement 1:

a) **Information costs** include costs to obtain, gather, collate, maintain, summarize, and communicate financial statement data to external users. Examples are the cost of computer hardware and software, fees paid to audit financial statement data, salaries and wages paid to corporate accounting staff in charge of the firm's financial accounting system, and costs to print and mail annual reports to shareholders or make them available electronically on the company's web site.

b) **Competitive disadvantage** costs occur when competitors are able to use the information in ways detrimental to the company. Examples include highlighting highly profitable products and services or geographical areas, technological innovations, new markets or product development plans, and pricing or advertising strategies.

c) **Litigation costs** are costs to defend the company against actions brought by shareholder and creditor lawsuits. These suits claim that previous information about the company's operating performance and health was misleading, false, or not disclosed in a timely manner. Examples include the direct costs paid to lawyers to defend against the suits, liability insurance costs, loss of reputation, the productive time lost by managers and employees as they prepare to defend themselves and the company against the suit.

d) **Political costs** arise when, for example, regulators and politicians use profit levels to argue that a company is earning excessive profits. Regulators and politicians advance their own interests by proposing taxes on the company or industry in an attempt to reduce the level of "excessive" profitability. These taxes represent a wealth transfer from the company's shareholders to other sectors of the economy. Managers of companies in politically sensitive industries sometimes adopt financial reporting practices that reduce the level of reported profitability to avoid potential political costs.

Requirement 2:

Student responses to this question may vary. One possible cost is when disclosure commits managers to a course of action that is not optimal for the company. For example, suppose a company discloses earnings and sales growth rate goals for a new product or market. If these projections become unreachable, managers may drop selling prices, offer "easy" credit terms, or overspend on advertising in an attempt to achieve the sales and earnings growth goals.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-4. Determining why financial reporting rules differ (LO 1-6)

A country's financial reporting philosophy evolves from and reflects the specific legal, political, and financial institutions within the country. External investors are a much more important source of financial capital in Canada and the United States than they had been historically in Germany and France. Consequently, financial accounting and reporting standards in Canada and the U.S. have evolved to meet this public financial market demand for information—what the chapter describes as the economic performance approach.

Prior to the adoption of IFRS by the European Union, financial accounting and reporting standards in Germany and France tended to reflect the commercial and tax law approach described in the chapter. Historically, in Germany and France, relatively small amounts of capital were provided by individual investors through public financial markets. The primary source of capital for German companies had been several large banks—and the government itself. Labor unions also played an important corporate governance role in German companies. Large banks provided much of the financing in France. Along with the German labor unions, these few important capital providers still wield great power including the ability to acquire information directly from the firm. Because of this concentrated power and the insignificance of the public financial market in these two countries, financial reporting standards tended to conform to income tax rules or commercial law.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

P1-5. Generally accepted accounting principles (GAAP) (LO 1-4)

Requirement 1:
What are generally accepted accounting principles (GAAP)? GAAP refers to the network of conventions, rules, guidelines and procedures that shape the financial reporting practices of businesses and non-profit organizations. GAAP comes from two main sources: (1) written pronouncements by designated standards-setting organizations such as the FASB, IASB and SEC; and (2) accounting practices that have evolved over time as preparers and auditors dealt with new business transactions and circumstances not yet described in written pronouncements. The FASB's Accounting Standards Codification is now the sole authoritative source for written GAAP, although suggested implementation guidelines are provided by industry trade groups and the AICPA through its various industry guides.

Requirement 2:
Why is GAAP important to independent auditors and to external users? Independent auditors provide reasonable assurance that the financial statements of the companies they audit "present fairly, in all material respects" the financial position, results of operations, and cash flows "in conformity with U.S. generally accepted accounting principles." It is therefore essential that independent auditors possess a thorough understanding of GAAP and how it applies to each specific client.

The goal of GAAP in the United States and most other developed countries is to ensure that a company's financial statements represent faithfully its economic condition and performance. GAAP achieves this goal by providing a framework for determining when to record a business transaction or event (recognition), what dollar amount to record (measurement), how summary information is to be displayed in financial statements (presentation), and what additional information to provide in the notes (disclosure). External users benefit when the GAAP framework ensures that the resulting statements and notes accurately convey information about a company's true economic condition and performance.

Requirement 3:
Describe the FASB organization and how it establishes new accounting standards. Although the Securities and Exchange Commission (SEC) has ultimate legal authority to determine accounting principles in the United States, it has looked to private-sector organizations to establish these principles. Today, the private sector standards setting organization is the FASB. It exists as an independent group with seven full-time members and a large staff. Board members are appointed for five-year terms and are required to sever all ties with the companies and institutions they served prior to joining the board.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

The FASB follows a “due process” procedure in developing accounting standards and updates that involves three steps: (1) Discussion-memorandum stage; (2) Exposure-draft stage; and (3) Voting stage. Public comments on discussion memoranda and exposure drafts are invited, and public hearings are sometimes held.

Requirement 4:
Describe the IASB organization and its role in establishing new accounting standards. The International Accounting Standards Board, formed in 1973, works to formulate accounting standards, promote their worldwide acceptance, and achieve greater convergence of financial reporting regulations, standards, and procedures across countries. Members are drawn from professional accounting organizations and businesses around the world.

Requirement 5:
How does the Securities and Exchange Commission (SEC) influence the financial reporting practices of U.S. companies? The SEC retains statutory power over the financial accounting and reporting practices of registrant companies. This power includes the ability to issue financial accounting and reporting rules as well as to enforce compliance with the rules it issues or those issued by standards-setting organizations (e.g., FASB) as designated by the SEC.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-6. Relevance versus faithful representation (LO 1-1)

Requirement 1:
The Blue Book average price is more ***relevant*** to the car buying decision than is the list (or "sticker") price shown on the manufacturer's web site. Why? Because it better represents the price you can expect to pay for the automobile.

The Blue Book price describes the average price actually paid by recent buyers for comparably equipped automobiles. Actual prices are the result of arms-length negotiations between willing buyers and sellers, and thus reflect what you can expect to pay (on average) when you negotiate your automobile purchase. The list ("sticker") price is just a suggested retail price—the actual negotiated price is often considerably less (but sometimes can be more) than the manufacturer's list price.

Requirement 2:
Both the list price and the Blue Book price have limitations with regard to **faithful representation**. The list price is free from **material error**, in that there is no variation in the amount. However, the value does not represent what a person can expect to pay for the car. In contrast, the Blue Book price of $39,500 is more consistent with the underlying economics, but is has more measurement error. Recent selling prices have ranged from $38,000 to $42,000. This means that while you can expect to pay $39,500 on average for the automobile, it may cost you as little as $38,000 or as much as $42,000.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

P1-7. Accounting Information Characteristics (LO 1-1)

Requirement 1:
"Cash" and "Net accounts receivable" are both ***relevant*** to the loan decision because they provide information about cash flows and thus about the company's ability to make principal and interest payments as they come due. The balance in "Accumulated depreciation", on the other hand, says nothing about the company's current or future cash. Consequently, this information is not relevant to the loan decision.

Requirement 2:
"Cash" is the most ***representationally faithful*** balance sheet item. The amount of cash on hand and in the bank at a particular moment in time can be determined with a high degree of accuracy. "Net accounts receivable" is less so because its determination requires estimates of future sales returns and bad debts. These estimates, which are essential to the accounting process, reduce the faithful representation of this balance sheet item. "Accumulated depreciation" is also less representationally faithful than "Cash" because its measurement requires estimates of salvage (residual) value and useful life.

P1-8. Accounting Conservatism (LO 1-1)

Requirement 1:
Conservatism means that when there is uncertainty about the correct accounting approach for an event, accountants choose the approach that leads to lower assets or higher liabilities. Possible losses—in this case, the decline in value of the land—should be recognized as soon as they become probable and measurable. Accounting conservatism requires that the land now be shown on the balance sheet at the lower amount $3 million, its estimated fair market value, rather than at the $5 million you paid two months ago.

Requirement 2:
Accounting conservatism requires that the land continue to be shown on the balance sheet at the price paid two months ago ($3 million) rather than the higher estimated fair value ($5 million) because of uncertainty around the value. Conservatism records losses as soon as they are probable and measurable, but additional requirements must be met to record gains (as you will see in Chapters 2, 4, and 11).

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-9. Factors Affecting Financial Reporting (LO 1-2, LO 1-3, LO 1-4)

1) Accounting is **not** an exact science. One reason this is the case is that many financial statement numbers are based on estimates of future conditions (e.g., future bad debts and warranty claims). Another reason is that there is no single accounting method that is best for all companies and situations. Thus, different companies use different methods to account for similar transactions (e.g., depreciation of property and the valuation of inventory).

2) While some managers may select accounting methods that produce the most accurate picture of a company's performance and condition, other managers may make financial reporting decisions that are self-serving and strategic. Consider the following examples:

- Managers who receive a bonus based on reported earnings or return on equity may make financial reporting decisions that accelerate revenue recognition and delay expense recognition in order to maximize the present value of their bonus payments.

- Managers who must adhere to limits on financial accounting ratios in debt covenants may make reporting decisions designed to avoid violation of these contracts.

- More generally, managers are likely to make financial reporting decisions that portray them in a good light.

The moral is that financial analysts should approach financial statements with some skepticism because management has tremendous influence over the reported numbers.

3) This is probably true. Financial accounting is a slave to many masters. Many different constituencies have a stake in financial accounting and reporting practices—existing shareholders, prospective shareholders, financial analysts, managers, employees, lenders, suppliers, customers, unions, government agencies, shareholder activist groups, and politicians. The amount and type of information that each group demands is likely to be different. As a result, accounting standards in the United States reflect the outcome of a process where each constituency tries to advance its interests. Examples illustrating the politics of accounting standards are interspersed throughout this book.

4) This is false. Even without mandatory disclosure rules by the FASB and SEC, companies have incentives to voluntarily disclose information that helps

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

them obtain debt and equity financing at the lowest possible cost. Failure to do so results in higher cost of debt and equity capital.

5) This is true. If the information is value-relevant—meaning, important for investors to know—there is no obvious reason not to disclose the information except when doing so places the company at a competitive disadvantage.

6) The best response is that the statement is false because:

- Managers have incentives to develop and maintain a good relationship with financial analysts. Failing to disclose value-relevant information (good or bad) on a timely basis can damage this relationship.

- Under the U.S. securities laws, shareholders can sue managers for failing to disclose material financial information on a timely basis. To reduce potential legal liability under shareholder lawsuits, managers have incentives to disclose even bad news in a timely manner.

7) This may be true or false. If a company discloses so little information that investors and lenders cannot adequately assess the expected return and risk of its securities, then its cost of capital will be high. In this case, managers are doing shareholders a disservice by not disclosing more information to financial markets. If, on the other hand, increased disclosure harms the company's competitive advantage, managers have helped shareholders.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-10. Economic Consequences of Accounting Standards (LO 1-3)

Requirement 1:
There are several economic consequences that could arise when companies are forced to alter their past accounting methods—in this case, by recording a new liability and corresponding expense.

Mandatory changes in accounting methods of this sort can disrupt contracts that are defined in terms of accounting ratios. One example is a loan agreement that restricts the firm from exceeding some maximum debt-to-equity ratio. The accounting change will add additional dollars to debt and simultaneously subtract dollars from equity, and thus may cause the firm to violate its lending agreement. The costs associated with violating the agreement represent an economic consequence of the accounting change.

In response to the possibility of violating the loan agreement, management may decide to sell some otherwise productive assets. The cash raised could then be used to pay down debt, and the accounting gain would increase reported equity. This would soften the adverse effect of the accounting change on the company's debt-to-equity ratio. But notice that the asset sale is occurring only in response to the accounting change—and thus it too represents an economic consequence of the change.

And, as described in requirement 2, management may decide to reduce or curtail employee healthcare benefits so that the recorded liability (and expense) is as small as possible. This benefit reduction becomes an economic consequence borne by employees of the company.

Requirement 2:
There are widely divergent views on whether the FASB should consider the economic consequences of its actions when formulating accounting standards.

On the one hand, *SFAC No. 2* states that "neutrality" is a desired characteristic of financial statement information. Neutrality means that the information cannot be selected to favor one set of interested parties over another. So, real liabilities cannot remain unrecorded just because recording them may cause some firms to violate their lending agreements. When applied to the standard setting process, neutrality means that the FASB should ignore the economic consequences of alternative accounting practices.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

A more practical problem is that it is exceedingly difficult to quantify those consequences in any meaningful way. How can the FASB determine which firms will likely violate their lending agreements or what it will cost them if they do so? And what about the economic consequences of likely changes in management's actions (e.g., asset sale, reduced employee benefits, etc.)? Even if the FASB was able to quantify all of the potential consequences associated with a particular proposed accounting change, it would still face the gargantuan task of deciding whether the total benefits outweighed the total costs to the various parties involved. For example, should lenders be favored and employees harmed by requiring heath care liabilities to be shown on the balance sheet? Or, should lenders be harmed and employees favored by keeping health care liabilities off the balance sheet?

Of course, the interested parties themselves fervently believe the FASB should consider the economic consequences of alternative accounting practices when formulating standards. To do otherwise, they argue, is to ignore a simple fact that mandatory accounting changes sometimes have real consequences.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-11. Two Sets of Books (LO 1-1)

Requirement 1:
Companies maintain a set of "tax" books to properly compute taxable income according to IRS rules. Companies maintain a set of GAAP books to properly compute net income, balance sheet amounts, and cash flows according to SEC and FASB rules. Because IRS rules differ from GAAP, two sets of books are required.

Requirement 2:
There are several reasons why it might not be a good idea to force companies to issue the same financial statements for both IRS and SEC purposes. For instance:

- The two regulatory agencies have entirely different financial reporting goals. The IRS is concerned with the timely collection of tax revenues in accordance with federal income tax law. The SEC (and the FASB) is concerned with ensuring that firms provide timely information useful for decision making purposes. There is no reason to believe that the same set of "books"—accounting procedures—can serve both purposes equally well.

- IRS rules for computing taxable income are determined by tax laws intended to achieve a variety of social purposes. The resulting income measure may not be particularly useful for other purposes like equity valuation or credit risk assessment.

- Political compromises have a substantial impact on tax law, and thus on IRS accounting. Requiring IRS and SEC conformity (i.e., a single set of books) would expose GAAP financial reporting standards to these same political winds.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-12. Worldwide Convergence of Accounting Standards (LO 1-7)

Requirement 1:
There are at least two arguments supporting worldwide convergence of accounting standards. These arguments involve the claimed benefits of increased financial statement **transparency** and **comparability**.

One argument for a common set of accounting standards is the global convergence of financial markets themselves. Foreign stocks and foreign investors make up an increasing fraction of the trading activity on most major stock exchanges today. A single set of worldwide accounting standards would eliminate local financial reporting differences, provide a common frame of reference for interpreting corporate financial reports, and thereby facilitate market efficiency. The gist of this argument is that convergence yields enhanced *comparability* across companies domiciled in different countries.

A second—and more controversial—argument is based on the notion that IASB standards are superior to those in use locally. According to this view, worldwide convergence eliminates local GAAP deficiencies and thus yields financial statements that better reflect the underlying economics of the business (enhanced *transparency*). These improvements in the quality of financial statement information then yield increased financial market efficiency.

As this chapter has stressed, the economics of accounting standard setting involves complicated cost and benefit tradeoffs. So, an obvious potential disadvantage of worldwide convergence is that, for many individual firms, the cost of convergence may exceed the benefits obtained. This might be especially true for small, publicly traded companies that rarely need access to new financial capital. A second disadvantage is the potential loss of competition in the market for accounting standards themselves. No single set of standards are likely to be universally preferred by all firms and all investors al of the time. Elimination of local standards may stifle financial reporting innovation.

Requirement 2:
According to Mr. Tweedie's remarks, convergence will likely increase investor confidence in China's capital markets and financial reports. This benefits the Chinese investor who buys stocks in local companies by ensuring that: (1) high quality financial information is readily available to support buy/sell decisions (better transparency); and (2) capital markets are efficient in reflecting that information in stock prices.

Requirement 3:

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

U.S. investors benefit in several ways. First, the cost of processing financial statement information about Chinese companies is reduced because U.S. investors would no longer need to be knowledgeable in both local and global GAAP (enhanced comparability). Second, the firm's cost of compliance with diverse accounting standards (a point mentioned in Mr. Tweedie's remarks) may also be reduced. This savings presumable makes the firm more valuable which benefits all investors.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

P1-13. Debt Covenants and Aggressive Accounting Practices (LO 1-4)

Requirement 1:
When a company violates its debt covenants, lenders can respond in any of several ways. They can simply waive the violation which is akin to a "slap on the wrist". Or, they can amend the loan agreement and thereby charge a higher rate of interest, accelerate repayment terms, or impose more stringent covenants on the borrower. (Chapter 8 tells you more.) If the lender refuses to waive or amend the loan terms, the borrowed amount becomes due immediately and this action may force the borrower to declare bankruptcy.

Requirement 2:
Although the details of the company's EBITDA covenant are not spelled out in the company's press release, Friedman's is required to maintain a minimum level of profitability (measured using EBITDA) over several periods. Aggressive accounting practices—premature revenue recognition or delayed expense recognition—could be used to keep EBITDA above the minimum required in the loan agreement. Examples might include underestimation of future uncollectibles, inappropriate capitalization of operating expenses, recognizing as sold items jewelry that is just being held pending approval by the customer.

Requirement 3:
Friedman's is required to maintain a minimum ratio of accounts payable to inventory. To avoid violating this minimum ratio requirement, the company could understate its actual inventory balance.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

P1-14. Toshiba Corporation (LO 1-6)

Requirement 1:
The company's March 31, 2018 annual report-financial review opens with a Management Discussion and Analysis typical of U.S. companies. This MD&A contains a five-year summary of selected income statement and balance sheet accounts, a review of operations and key performance indicators (e.g., ROE, Debt/Equity), results by geographical region and industry segment, capital expenditures and construction plans, along with a discussion of cash flows and treasury stock transactions. The MD&A also describes significant risk factors that the company and its businesses must confront.

Requirement 2:
The following financial statements are included in the 2018 annual report: Consolidated Balance Sheets, Statements of Operations, Statements of Comprehensive Income, Statements of Shareholders Equity, and Statements of Cash Flows each denominated in Japanese yen and for the most recent year, in U.S. dollars.

Requirement 3:
According to Note 1 Summary of Significant Accounting Policies, the company's financial statements are prepared in accordance with U.S. GAAP. However, the note indicates where U.S. GAAP differs from Japanese principles and methods.

Requirement 4:
Note 1 states that Toshiba issued American Deposit Receipts (ADRs) in 1962 and has prepared financial statements under U.S. GAAP since that time. The Japanese Minister of Finance approved this format. Currently, the common stock is traded on the Tokyo Stock Exchange (TSE) and Nagoya Stock Exchange (NSE) (page 17).

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

P1-15. Carrefour Group (LO 1-7)

Requirement 1:
The company's 2018 consolidated financial statements include the consolidated financial statements of income, comprehensive income, financial position, cash flows, and changes in shareholders' equity, and notes to consolidated financial statements.

Requirement 2:
Most of the annual report is devoted to describing the company, its strategic goals and core values including the customer value proposition: brand strategy, store configuration and development goals, convenience and pricing. A section of the annual report discusses the company's commitment to socially responsible business activities including employee relations and environmental footprint. It also reports its performance for various components of a Corporate Social Responsibility (CSR) index.

Requirement 3:
Note 1.1 states that Carrefour's consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use by the European Union. Note 1.1 also states that the statements "include the material disclosures required by Standard no. 2016-09 published by the French accounting authorities".

Requirement 4:
The order in which individual accounts are listed by Carrefour Group on the asset side and liabilities/equity side of the statement of financial position is the reverse of what is common among U.S. companies. For example, the first asset listed is Goodwill, followed by other intangibles and long-term investments. Next come current assets, starting with inventories and ending with Cash and non-current assets held for sale. The liabilities/equity portion of the balance sheet lists shareholders' equity accounts first, followed by long-term borrowing and other long-term obligations, with current liabilities (short-term borrowing and accounts payable) shown last.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-16. Siemens AG (LO 1-5)

Requirement 1:
Siemens (p.4) reports information under the following categories:

- Sustainable development of societies
- Sustainability Management
- Customers
- Research and development
- People and society
- Environment
- Responsible business practices

Requirement 2:
Page 45 states that the report has been prepared in accordance with the GRI Standards: Comprehensive option. In addition, it uses the United Nations (UN) Guiding Principles Reporting Framework for reporting on human rights activities. In addition, it presents progress related the UN CEO Water Mandate. Page 2 states that it follows the UN's Agenda 30 and its Sustainable Development Goals as a guideline. Any of these statements would be acceptable.

Requirement 3:
Page 25 shows that Siemens decreased its output of CO_2 from 2.2 million metric tons in 2014 to 1.5 million metric tons in 2018.

Requirement 4:
Page 2 states that Siemens wishes to provide innovations that improve the quality of life for its stakeholders: investors, employees, customers, partners, and societies. The company has also developed a strategy around sustainable practices. The report details their efforts and progress. Based on the discussion from the chapter, Siemens also is responding to information demands of investors, customers, and regulators.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

P1-17. Sustainability Accounting (LO 1-5)

Requirement 1:
As investors and creditors see the effects of climate change around the world, they want to understand the company-specific risks and opportunities. In addition, investors and creditors recognize the importance of good corporate governance and sustainable business practices, and they wish to compare these practices across firms.

Requirement 2:
The key organizations are the Global Reporting Initiative, the CDP, the United Nations, the G20, and the Sustainability Accounting Standards Board (SASB).

Requirement 3:
Companies would need to disclose risks and opportunities associated with the following four categories: pending or existing regulation, international accords, indirect consequences of regulation or business trends, and physical impacts such as high sea levels or water availability.

Requirement 4:
Many investors, creditors, customers, and governments want to know about a company's impact on the environment, risks and opportunities caused by climate change, and efforts to maintain a sustainable business. Companies are trying to meet this demand by supplying sustainability reports.

Requirement 5:
Lower carbon emissions may yield positive perceptions from stakeholders, a more committed work force, and fewer future regulation costs. Higher levels of carbon emissions may indicate higher risk, which would reduce share price.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

P1-18. Southwest Airlines Co. (LO 1-3)

Requirement 1:
Southwest Airlines is a major passenger airline that provides scheduled air transportation in the United States and near-international markets (page 3).

Requirement 2:
Nonfinancial metrics include revenue passengers carried, revenue passenger miles, available seat miles, average passenger fare, and load factor (revenue passenger miles divided by available seat miles).

Requirement 3:
The investors and creditors may use the nonfinancial information to help them understand current financial results or predict future results. For example, a lower load factor (defined in requirement 2) would help explain lower revenue for the current year.

Requirement 4:
Investors and creditors demand the information so that they can understand better the financial results. Southwest management may also want them to understand better the parts of their business that influence results.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis (7th Ed.)
Chapter 1 Solutions
The Economic and Institutional Setting for Financial Reporting
Cases

Cases

C1-1. Novartis AG: Form 20-F Reconciliation (LO 1-6)

Requirement 1:
For 2006, the difference between IFRS net income from continuing operations ($7,019) and US GAAP net income from continuing operations ($5,150) is $1,869 million.

Requirement 2:
Most people would argue that Novartis management would prefer to report the high dollar amount (IFRS net income) rather than the lower US GAAP amount. Reporting higher net income paints a more favorable picture of company profitability. However, doing so may also attract unwanted attention from labor unions, politicians, regulatory agencies, and the financial press.

Requirement 3:
Which is warmer, a room with a temperature of 22.2 Celsius or one where the temperature is 72 Fahrenheit? Even though "72" is bigger than "22.2", neither room is warmer than the other. The difference in measurement scale readings (72 versus 22.2) does not translate into a difference in actual temperature.

Sophisticated investors understand that a similar concept applies to income measured using two different accounting scales: U.S. GAAP and non-U.S. GAAP. Moreover, most investors realize that the absolute dollar level reported by a company is less important than whether earnings are increasing, decreasing, or remaining flat relative to their level one year ago.

Requirement 4:
Investors who contemplate buying (selling) a foreign company's stock traded on a U.S. stock exchange may evaluate its relative profit performance against that of familiar U.S. companies. The Form 20-F reconciliation aids this comparison process by providing investors with an earnings measure that is directly comparable to those reported by U.S. companies.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

Requirement 5:
Form 20-F reconciliations of non-U.S. GAAP earnings to U.S. GAAP earnings are less important to investors in this setting. There may be rare cases where investors who contemplate buying (selling) a foreign company's stock traded on a foreign stock exchange want to evaluate its relative profit performance against that of familiar U.S. companies that also are traded on the same foreign exchange. If so, the Form 20-F reconciliation aids this comparison process by providing investors with an earnings measure that is directly comparable to those reported by U.S. companies.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

C1-2. Conrad Company: Announcing sales and earnings goals (LO 1-3)

Requirement A:
1) Potential **costs** of announcing earnings and sales goals include:
(a) possible shareholder lawsuits if goals are not met; (b) loss of reputation if goals are not met; (c) disclosure may convey information to competitors about the profitability of products or market territories; (d) managers may take dysfunctional actions—ease credit terms, decrease advertising expenditures, reduce R&D expenditures—near the end of the accounting period if it looks like the goals will not be met.

Potential **benefits** include: (a) investors can better understand the risks and rewards of stock ownership because they know more about the management's plans; (b) disclosure may improve relationships with lead investors and analysts, especially if it's part of an ongoing communications strategy and not just a one-time event; (c) investor and creditor uncertainty may be reduced, thus lowering the company's cost of debt and equity financing.

2) Should management disclose its earnings and sales goals? It depends on whether the benefits outweigh the costs, and on how confident management is that the goals can be achieved.

Easily achievable goals are likely to be disclosed without much reservation. Difficult goals are less likely to be disclosed because management may not want to risk disappointing investors if results fall short of target. One way to avoid disappointment is to make the goals less specific—for example, "sales are expected to increase by as much as 15%" or "sales are expected to be up substantially next year."

3) In all likelihood, the recommendation would change. Consideration would now be given to the fact that, as the planning horizon increases, it becomes more and more difficult to forecast accurately. For example, major changes in market-wide and industry-wide competitive conditions over the next two or three years could have a dramatic impact on whether or not the goals can be achieved.

Requirement B:
In this case, the nature of the goals is quite varied. In all likelihood, investors and financial analysts are going to be more interested in profitability and cash flow forecasts than in other financial aspects of the company. As a result, it is reasonable to recommend disclosure of the following goals—subject to the cost and benefit considerations mentioned earlier: annual sales growth of

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

15%; annual earnings growth of 20%; a return on net tangible assets of 16%; a return on common equity of 20%; a minimum profit margin of 5%.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

C1-3. Raytheon Company: Disclosing major customers (LO 1-2)

Requirement 1:
The SEC requires firms to alert financial statement readers about major customers that contribute 10% or more to annual sales. Such information helps investors and analysts assess sales volatility and the potential impact on profitability of the loss of major customers. The information is especially important for companies operating in industries characterized by high customer concentration and intense competition.

Requirement 2:
Financial analysts might use these disclosures in the following ways:

- To assess customer risk. The more revenue a company derives from a single customer or small group of customers, the greater the adverse impact on profitability if one or more of these customers is lost to a competitor or simply goes out of business.

- By studying a firm's major customers (i.e., the products they sell, expected future demand for such products, untapped markets in other countries or geographical areas), an analyst can determine the likelihood of increased future sales to that customer and, hence, profits to the selling company. However, the name of a major customer need not be disclosed so analysts may not always be able to specifically target such information.

- Because Raytheon obtains 68% of its revenue from the U.S. government, investors would want to pay attention to elections and deficit levels to predict future revenues.

Requirement 3:
Raytheon produces sophisticated military equipment. Major customers, such as the United States, would monitor the financial health of Raytheon to ensure that it can rely upon it as a military supplier. This would be especially important when the U.S. is fighting a war.

Requirement 4:

Raytheon monitors the financial health of key customers to ensure that they will be a continuing source of demand for its services in the future. Like its investors, Raytheon will monitor elections, government policies, and budget deficits. For example, if the country elects a president who wants to reduce the military, Raytheon would plan for lower cash inflows.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

C1-4. The gap in GAAP (LO 1-4)

1) Advantages of allowing managers some flexibility in the choice of financial reporting methods include:

- Accounting must serve as a slave to many masters. Stated differently, financial accounting information is used for many purposes including valuation, credit analysis, and contracting, and no single set of financial reporting methods would serve each of these purposes equally well. By allowing managers some latitude in the choice of financial reporting methods, they can weigh the trade-offs implicit in making the firm's financial reports informative for each of these potential uses.

- If managers have some latitude in their choice of financial reporting methods, they can adapt the firm's financial reporting practices to changes in the firm's economic characteristics and/or environment over time. For example, a change in the rate of technological advance in a firm's industry may mean that new long-term assets should be written off at a faster rate than was previously the case. For example, a company that previously used straight-line depreciation may now find that accelerated depreciation presents the most accurate picture of the firm's economic environment.

2) The current financial reporting system in the United States is really a combination of the two approaches.

On the one hand, firms have latitude in the selection of accounting methods to summarize various transactions and events. Examples include inventory valuation where firms may select from LIFO, FIFO, or weighted average; depreciation policy where they may select from straight-line or accelerated methods such as sum-of-the-years'-digits or declining-balance methods; and accounting for oil and gas exploration costs where firms may apply the full-cost or the successful-efforts method.

On the other hand, there are numerous cases where the FASB (or SEC) has mandated a single accounting method or treatment for various transactions or events. Examples include research and development expenditures which must be expensed in the year incurred; leases which must be capitalized and reported as liabilities on the balance sheet if certain criteria are met; accounting for foreign currency translation; and accounting for pension benefits and other postemployment benefits other than pensions.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

3) The **advantages** of a single set of accounting methods include:

- Facilitates comparability of financial information across firms at a point in time and over time. This may be appealing to financial analysts because it potentially makes their work easier.

- Ease of verification by the auditing profession. This may lead to fewer shareholder lawsuits against the company or its auditors for aggressive financial reporting decisions made by managers. External auditors may find the ease of verification beneficial to them.

The **disadvantages** of a single set of accounting methods include:

- Assumes that the financial performance and condition of all firms can adequately be captured by a single set of accounting methods. Implicitly assumes that firms are homogeneous. Moreover, that all firms have identical economic features and characteristics and face identical economic environments.

- Assumes that a single set of accounting methods serves all the potential uses of financial statement information (e.g., valuation, credit analysis, and contracting).

The **advantages** of allowing flexibility in the choice of financial reporting methods include:

- Firms can tailor their choice of financial reporting methods to the specifics of their economic environment and circumstances. For example, depending on whether the prices of its input products are increasing or decreasing, FIFO may be a more realistic choice of inventory valuation method for income determination purposes when compared to LIFO (or vice versa). As another example, in industries where long-term aspects are subject to a rapid rate of technological advance and change, accelerated depreciation methods may be superior for income determination purposes when compared to straight-line (or vice versa).

The **disadvantages** of allowing some flexibility in the choice of financial reporting methods include:

- May detract from making comparisons across firms at a point in time and over time.

- Managers may use their discretion over reporting methods to distort the firm's performance. They might adopt financial reporting practices that

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

create the appearance of profitability in an attempt to hide or cover up poor operating performance. They might also adopt financial reporting practices that accelerate the recognition of revenues and delay the recognition of expenses in an attempt to maximize the present value of payouts from bonus plans tied to reported profitability.

Copyright © 2021 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

CHAPTER 1
THE ECONOMIC AND INSTITUTIONAL SETTING FOR FINANCIAL REPORTING

CHAPTER OVERVIEW

Financial statements are an extremely important source of information about a company, its economic health, and its prospects. They help improve decision making and make it possible to monitor managers' activities.

- Equity investors use financial statements to form opinions about the value of a company and its stock.
- Creditors use statement information to gauge a company's ability to repay its debt and to check whether the company is complying with loan covenants.
- Stock analysts, brokers, and portfolio managers use financial statements as the basis for their recommendations to investors and creditors.
- Auditors use financial statements to help design more effective audits by spotting areas of potential reporting abuses.

Investors, creditors, and other interested parties demand financial statements because the information is useful. But what governs the supply of financial information?

- Mandatory reporting is a partial answer. Most companies in the United States and other developed countries are required to compile and distribute financial statements to shareholders and to file a copy with a government agency (in the United States, that agency is the SEC). This requirement allows all interested parties to view the statements.
- The advantages of voluntary disclosure are the rest of the answer. Financial information that goes beyond the minimum requirements can benefit the company, its managers, and its owners. For example, voluntary financial disclosures can help the company obtain capital more cheaply or negotiate better terms from suppliers. Some companies routinely disclose nonfinancial metrics that can assist in the prediction of future performance. But benefits like these come with potential costs: information collection, processing, and dissemination costs; competitive disadvantage costs; litigation costs; and political costs. This means that two companies with different financial reporting benefits and costs are likely to choose different accounting policies and reporting strategies.

Different companies choose different accounting policies and reporting strategies because financial reporting standards are often imprecise and open to interpretation. This imprecision gives managers an opportunity to shape financial statements in ways that allow them to achieve specific reporting goals.

- Most managers use their accounting flexibility to paint a truthful economic picture of the company.

Copyright © 2021 McGraw-Hill. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

- Other managers mold the financial statements to mask weaknesses and to hide problems.
- Analysts who understand financial reporting, managers' incentives, and the accounting flexibility available to managers will maintain a healthy skepticism about the numbers and recognize that financial statements sometimes conceal more than they reveal.

The accountant's and analyst's job is made more difficult when financial reporting measurement and disclosure rules differ across national boundaries. Reporting rules in some countries such as Canada, the United Kingdom, and the United States evolved to reflect firms' underlying economic performance. But reporting rules in many other countries—France, Germany, and Japan, for example—merely complied with taxation or other statutory requirements.

- Globalization forced many firms in countries using a commercial or tax law approach to seek foreign capital. In turn, this has led countries around the world to move to IFRS, making it easier for firms in their countries to raise capital in domestic and foreign financial markets.
- The FASB and IASB have worked to converge the guidance for numerous accounting issues. However, in many cases, the boards have issued substantially different standards after having worked together originally.

CHAPTER OUTLINE

I. Why Financial Statements Are Important

Teaching Tip: While financial statements are not as timely as press releases, they do provide an economic history and are indispensable in developing an accurate profile of ongoing performance and prospects.

Teaching Tip: This text does not focus on assisting readers of financial statements in detecting fraud, which is rare. Rather, the purpose of this text is to assist readers in understanding the financial flexibility and discretion inherent in financial accounting rules in order that they may make more informed decisions.

II. Economics of Accounting Information
- A. Demand for Financial Statements
- B. Disclosure Incentives and the Supply of Financial Information

III. A Closer Look at Professional Analysts
- A. Analysts' Decisions

IV. Fundamental Concepts of Financial Reporting
- A. Generally Accepted Accounting Principles
- B. Who Determines the Standards?
- C. The Politics of Accounting Standards
- D. FASB Accounting Standards Codification™

Copyright © 2021 McGraw-Hill. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

Teaching Tip: It may be a good idea to access the FASB Codification and provide an overview of how to use the system and reinforce that everything in the Codification is a Generally Accepted Accounting Principle.

V. Incentive Conflicts and Financial Reporting

Teaching Tip: For example, the choice to capitalize, rather than expense amounts, will make firms appear to be larger, more profitable, and less risky. Therefore, naive acceptance of financial statement data may be dangerous. Much of the book is devoted to providing students with the skills necessary to become more informed readers of financial statements by making meaningful comparisons between companies and gaining insight into managers' incentives.

VI. Sustainability Accounting

VII. An International Perspective

A. International Financial Reporting
B. Globalization and the Rise of IFRS

VIII. APPENDIX 1A: GAAP in the United States

A. Early Developments
B. Emergence of GAAP
C. Current Institutional Structure in the United States

CHAPTER QUIZ

1. A company's financial statements reflect information about
   a. product information and competitive positions.
   b. future projections of sales, expenses, and other future economic events.
   c. the general economy of the industry in which the company operates.
   d. economic events that affect a company that can be translated into accounting numbers.

2. Creditors assess credit risk by comparing a firm's required principal and interest payments to estimates of the firm's current and future
   a. cash flows.
   b. net assets.
   c. revenue.
   d. net income.

3. Which is not correct regarding Regulation Fair Disclosure (Reg FD)?
   a. It limits what management can say in private conversations with analysts and investors.
   b. It does not limit what management can say in private conversations with analysts or investors.
   c. It was passed by the SEC.
   d. It helps level the playing field between individual and institutional investors.

Copyright © 2021 McGraw-Hill. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

4. Being verifiable and neutral is part of what makes financial information
   a. consistent.
   b. comparable.
   c. relevant.
   d. useful.

5. Financial information capable of making a difference in a decision is
   a. relevant.
   b. reliable.
   c. consistent.
   d. verifiable.

6. Factors that may influence a decision maker's judgment as to what accounting information is useful include:
   a. The decision to be made.
   b. The information already possessed.
   c. The decision maker's capacity to process the information.
   d. All of the above answers are correct.

7. Which one of the following types of disclosure costs is the cost of disclosing the company's pricing strategies?
   a. Political cost
   b. Litigation cost
   c. Competitive disadvantage cost
   d. Information collection, processing, and dissemination cost

8. Employees demand financial statement information because the firm's performance is often linked to
   a. Employee stock ownership plans.
   b. Social security benefits.
   c. Disability plan benefits.
   d. Workmen's compensation benefits.

9. The primary current source of generally accepted accounting principles for publicly traded companies in the United States rests with the:
   a. Securities and Exchange Commission.
   b. New York Stock Exchange.
   c. Financial Accounting Standards Board.
   d. American Institute of Certified Public Accountants.

10. International accounting standards are established by the
    a. Securities Exchange Commission
    b. London Stock Exchange
    c. International Accounting Standards Board
    d. Institute of Chartered Accountants

Copyright © 2021 McGraw-Hill. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual

Essay Questions

1. Define the expanded role of the PCAOB in the preparation of consistent and transparent financial statements.

2. Why would it be beneficial to narrow international differences in accounting rules for accounting and reporting?

3. Discuss nonfinancial metrics that companies use and how they can be used by investors and creditors.

4. Discuss sustainability accounting and the importance of uniform disclosures about climate change.

QUIZ ANSWERS:

1. *D*. The financial statements present historical information about what has happened to the company in the past.
2. *A*. Creditors are concerned with a firm's ability to repay principal and interest by projecting cash flows.
3. *B*. Reg FD was passed to limit what management can say in private to analysts and investors.
4. *D*. Useful information is verifiable and neutral.
5. *A*. Relevant information is capable of making a difference in decision making.
6. *D*. The judgment by a decision maker as to what accounting information can be useful includes the decision to be made, the information already possessed, and the decision maker's capacity to process the information.
7. *C*. Competitive disadvantage cost is the cost of disclosing the company's pricing strategies.
8. *A*. Managers and employees use financial information to monitor employee contracts such as bonus plans, profit–sharing plans, and pension plans.
9. *C*. The FASB is charged with the responsibility of establishing financial accounting standards.
10. *C*. The IASB is responsible for establishing IFRS.

RECOMMENDED FIGURES AND EXHIBITS

1. Exhibit 1.1—Nonfinancial Metric Examples

2. Figure 1.1—Desirable Characteristics of Accounting Information

Copyright © 2021 McGraw-Hill. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill.

Financial Reporting and Analysis 8th edition Revsine Solutions Manual