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1-1. General-purpose financial statements are designed to meet the needs of external decision makers. The general purpose because they are designed to be used by diverse groups of decision makers, such as invest creditors, and other interested parties.

The components of general-purpose financial statements typically include:

1. Income statement: A periodic statement of results of operations.

2. Comprehensive income statement: A periodic statement of results of operations and other comprehensi

3. Balance sheet: A periodic statement of financial position.

4. Statement of cash flows: A periodic statement of cash inflows and outflows.

5. Statement of stockholders' equity: Reports the beginning equity balances, activity, and the ending equity

1-2. Financial statements include specific reports: comprehensive income statement (or a separate income and a comprehensive income statement), cash flow statement, balance sheet, and stockholders' equity sta Financial reporting is the process of communicating financial information, which includes the financial sta plus other reports such as press releases, management discussion & analysis, etc.

1-3. The basic objective of general-purpose financial reporting is to provide financial information about the entity that is useful to existing and potential investors, lenders, and other creditors in making decisions abc providing resources to the entity. Those decisions involve buying, selling, or holding equity and such instru providing or settling loans and other forms of credit.

1-4. Financial reporting is geared toward external users because they have an immediate need for financial information and are not able to directly access the information. The conceptual framework indicates that f information providers may assume that financial statement users are reasonably informed of business and activities and will diligently review and analyze the financial information presented.

1-5. The emphasis in financial accounting is placed on communication because the financial statements are source of information that users rely on in making investment decisions. The statements must be compreh the users.

1-6. Yes, financial statements do include data based on assumptions about the future. For example, the all bad debts is an estimate of future uncollectible accounts receivable.

1-7. The primary formulator of GAAP is the FASB. Although the SEC has the authority to formulate GAAP, t delegated this authority to the private sector. However, the SEC may require a change to the accounting st any time.

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1-8. The establishment of the FASB was brought about due to complaints both from within and outside the accounting profession, with respect to the establishment of accounting standards. These complaints relate representation of the APB's members and the independence of the views of the members, nearly all of whi employed full time by their accounting firms. A committee was appointed to "study the issues and problem involved in the establishment of accounting principles, together with recommendations for improving the p and making it more responsive to the needs of those who relyon financial statements." In March 1972, the committee presented a report in which it recommended a Financial Accounting Foundation, a Financial Acc Standards Board (FASB), a Financial Accounting Standards Advisory Council, and a better structuring of the used to develop accounting standards. These recommendations were accepted by the AICPA and, as a resu FASB became operational July 1, 1973. The FASB serves as an independent board to prescribe accounting s

1-9. A number of recommendations resulted from the Wheat Committee which examined the issues with t accounting boards (Accounting Principles Board and Committee on Accounting Procedure) which when implemented contribute to the efficiency of the FASB. These including the following:

1. Smaller board size of 7 voting members.
2. Financial independence including funding and full salaries for the board members.
3. Autonomy where board members cannot retain investments in other companies.
4. Broader representation where all board members are not required to be CPAs.
4. Advisory support through a supporting committee (FASAC).
6. Greater continuity through renewable five-year terms.

1-10. The SEC exerts a continuing influence on the establishment of accounting standards. The Commission given legal statutory authority to prescribe external financial reporting requirements for those companies u jurisdiction. However, the SEC generally has elected to rely upon the accounting profession to establish and accounting standards and to regulate the profession. There is a positive working relationship between the S the accounting profession. However, there have been occasions when the SEC felt the public interest was n fully served and forced the accounting profession to address critical problems. In a few instances, the SEC h prescribed certain accounting and reporting practices without waiting for action by the profession. In at lea case it did not accept a proposed FASB standard. The SEC is responsible for the enforcing compliance with t accounting standards for required registrants of the SEC.

1-11. GAAP is the body of concepts, principles, and procedures that guides the preparation of financial stat GAAP is organized within the Codification system and is updated by the FASB through Accounting Standard Updates. Prior to the consolidation of GAAP in the Codification, GAAP consisted of multiple-source docum produced by the FASB, the AICPA, the EITF and other standard setters.

1-12. The essence of the FASB's due process procedure is to provide an open format that allows an opportu interested parties to express their views before decisions on reporting standards are reached.

1-13. The Sarbanes Oxley Act is a law passed in 2002 to mandate reforms to enhance corporate responsibil enhance financial disclosures, and combat accounting fraud. Key topics include the establishment of the Pu Company Accounting Oversight Board to oversee the auditing profession, personal financial statement cert by CEOs and CFOs, independence of audit services, formal internal control assessments, audit committee requirements and required periodic review of company's periodic financial statements filed with the SEC.

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1-14. Early events: The growth of large corporations and the need to raise capital from outside investors. T development of regulation and taxation. The stock market crash of 1929.

Later events: The ineffectiveness of the CAP and the APB under increasingly complex reporting. The establ of the FASB and the movement toward a conceptual framework.

Related events: The interest of Congress in resource allocation decisions influenced by financial reporting a mandated responsibility for financial reporting oversight resting with the SEC. Attempts to converge GAAP also influenced the development of accounting standards in recent years.

1-15. The FASB's due process procedures includes the following steps: Topic identification through researcl feedback review, agenda decisions, deliberations at public meetings, public feedback, additional hearings c tables, and perhaps the issuance of a final standard. In practice, the FASB conducts a transparent process c where the FASB seeks feedback, posts publicly the feedback received, and reacts to the feedback. With mo complex issues, the FASB may send out several versions of a standard, which is updated based upon feedba research, and deliberations.

1-16. The "due process" system used by the FASB is designed to help the Board learn about the issues and consensus about an accounting standard. This process works through careful identification of accounting is research related to the issue, and providing opportunity for all interested parties to express their views wh gradually becoming comfortable with the new standard. A consensus about accounting standards is impor because, in the final analysis, a standard will not survive long unless there is recognition that it is good for r rather than less, of the interested parties—preparers, auditors, and users. Usually this is not true of an indi standard. But standards taken as a group must be generally accepted. General consensus is reached throug use of an elaborate due process, including discussion memorandums, public hearings, and exposure drafts, which interested parties are allowed to respond to proposed accounting standards.

1-17. The Codification is important because it represents *the single source* of GAAP that is updated with cha ratified by the FASB. Companies in the U.S. registered with the SEC follow GAAP when preparing financial statements.

1-18. The mission of the IASB is to produce a single set of high quality, understandable, enforceable, compa and globally accepted financial reporting standards based upon clearly articulated principles. Ultimately, th would like to bring transparency, accountability, and efficiency to financial markets around the world.

1-19. The FASB developed a conceptual framework to serve as a constitution to guide it in the deliberations necessary to the formulation of GAAP. A major hope is that the conceptual framework would contribute to consistency and provide the theoretical underpinnings to support solutions to accounting and reporting pro

1-20. The qualitative characteristics of accounting information include fundamental characteristics (capable making a difference to external users) and faithful representation (represents the relevant phenomena tha purports to represent).

1-21. Cost effectiveness is a constraint to accounting standard setting because it requires that costs to repo financial information be justified by the benefits of reporting that information.

1-22. A revenue is an inflow or other enhancement of assets, or decrease in a liability that results from the ongoing or central activities. In contrast, a gain results from peripheral or incidental transactions of an enti investment by owner is an increase in equity resulting from a transfer of something valuable to the compar exchange for ownership interest.

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1-23. An expense is an outflow or other "using up" of assets or incurrence of liabilities that constitutes the ongoing major or central activities. In contrast, a loss results from peripheral or incidental transactions of tl entity. A distribution to an owner is a decrease in equity resulting from a transfer of assets (or increase in liabilities) to the owner.

1-24. The four assumptions include economic entity (economic activities considered an identifiable accoun unit), going concern (business is not expected to liquidate for the foreseeable future), monetary unit (resul company's economic activities are reported in the U.S. dollar), and periodicity (changes in a company's fina position are reported over a series of distinct time periods).

1-25. Assets and liabilities are measured at net realizable value (liquidation basis) if a company no longer ca assume a going concern.

1-26. The periodicity assumption gives rise to accruals and deferrals in accounting because of the need for term periodic reports during the life span of a business. This means that a number of transactions that affe than one period must be interrupted with an arbitrary cutoff (example, prepaid insurance).

1-27. The four accounting principles include measurement (mix of measurement models including historica and fair value), revenue recognition (revenue recognized in the period when the seller satisfies its performa obligation), expense recognition (expense is recognized directly related to revenue, as incurred, or systema and rationally over time), and full disclosure (financial statements report all relevant information).

1-28. GAAP is described as a mixed-attributed measurement model because amounts in the financial state are measured primarily at historical cost (original exchange price) or fair value (price that would be receive an asset or paid to transfer a liability).

1-29. The revenue recognition process begins with a contract between the seller and the customer where t seller makes a contractual promise to transfer goods or services to a customer in exchange for considerati Revenue is recognized in the period when the seller satisfies its performance obligation.

1-30. Expense is recognized directly related to revenue or as revenue is recognized, as incurred to obtain b exhausted within the period, or systematically and rationally over time because the expense is incurred to benefits over several periods of time.

1-31. The fair value hierarchy categorizes inputs into three levels: Level 1 (inputs are quoted prices in activ markets), Level 2 (inputs other than quoted prices are observable either directly or indirectly), and Level 3 are unobservable inputs). When a financial amount is measured at fair value, the company must disclose th classification of the item according to the fair value hierarchy.

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BE 1-32

a. Aligned
b. Not aligned
c. Not aligned
d. Aligned
e. Aligned

BE 1-33

1. e
2. d
3. a
4. c
5. b

BE 1-34

a. Free from error - faithful representation
b. Confirmatory value - relevance
c. Materiality - relevance
d. Neutrality - faithful representation
e. Predictive value - relevance
f. Completeness - faithful representation

BE 1-35

a. free from error
b. completeness
c. confirmatory value
d. predictive value
e. neutrality
f. materiality

BE 1-36

a. comparability
b. verifiability
c. understandability
d. timeliness

BE 1-37

a. Expense
b. Distribution to owners
c. Investment by owners
d. Gain
e. Expense

BE 1-38

a. Periodicity
b. Monetary unit
c. Economic entity
d. Going concern

BE 1-39

a. Full disclosure
b. Measurement
c. Expense recognition
d. Revenue recognition

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BE 1-40

a. Fair value hierarchy: Level 2
b. Fair value hierarchy: Level 3
c. Fair value hierarchy: Level 1

BE 1-41

a. Ratable allocation of the cost of an annual license to expense reflects the expense recognition principle. The license year and the licensee's accounting year may not coincide.

b The economic entity assumption is manifested by preparation of separate statements for each entity in which Williams has an ownership interest.

c. Valuation of inventories at lower of cost or net realizable value reflects both expense recognition, in that apparent losses are debited to the period in which they occurred, and faithful representation, in that future value of the inventories may be below their cost.

d. Ignoring inflation reflects adherence to monetary unit assumption.

e. Reporting existence of the lawsuit reflects the full disclosure principle. This fact, which could materially affect the future of AtoZ, is not concealed; disclosure is adequate.

BE 1-42

a. Expense recognition (Expense should be spread over the expected useful life of the asset in such a way as to allocate it as equitably as possible to the periods during which services are obtained from the use of the asset.)
b. Economic entity (Consolidated statements combine multiple entities into one.)
c. Measurement (Currently, land is reported under the historical cost.)
d. Full disclosure (GAAP requires information about contingencies to be disclosed.)

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E 1-43. Objective of Financial Reporting

a True
b False: prepared for external users
c True
d False: also requires a statement of stockholders' equity and a comprehensive income statement
e True
f True
g False: Financial accounting under GAAP employs accrual accounting, however a statement of cash flows (that employs cash basis accounting) is one of the required statements.
h True

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E 1-44. Influencers of GAAP Development

a FASB
b AICPA
c FASB
d SEC
e AICPA
f FASB
g FASB
h SEC
i AICPA
j FASB

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E 1-45. Qualitative Characteristics

1	d	Completeness
2	f	Free from error
3	i	Timeliness
4	b	Confirmatory value
5	g	Comparability
6	a	Predictive value
7	j	Understandability
8	h	Verifiability
9	c	Materiality
10	e	Neutrality

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E 1-46. Fundamental Qualitative Characteristics

a	Relevance	predictive value
b	Faithful representation	completeness
c	Faithful representation	neutrality
d	Relevance	confirmatory value
e	Relevance	materiality
f	Faithful representation	free from error

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E 1-47. Enhancing Qualitative Characteristics

a verifiability
b timeliness
c comparability
d understandability
e comparability

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E 1-48. Qualitative Characteristics

1.
(a) **Materiality.** *An amount, if omitted or misstated, may influence decisions that the users make. The cost of the wrench is an immaterial* amount.
(b) **No.** *The company's policy here is consistent with the materiality concept (small amount).*

2.
(a) **Comparability.** *Accounting standards and procedures should be applied consistently from period to period within a given entity.*
(b) **Yes.** The company violated consistency; to implement consistency the company should keep the same inventory cost-flow assumption (unless
moving from LIFO was justified because prices were no longer increasing).

3.
(a) **Comparability.** *Comparability involves the comparison of the company's accounting information with similar information about* other companies.
(b) **Yes.** *The company is violating comparability relative to its major competitors. Statement users may be better served if the companies in an industry report on a comparable basis. However, in this situation GAAP permits either method. If the company can support using an accelerated depreciation method, it would make sense to continue to use that method.*

4.
(a) **Free from error.** *Accounting information should be free from error.*
(b) **Yes.** *There is a significant bias to consistently understate depreciation expense. The company policy should be changed to use the most reliable estimate of useful life.*

5.
(a) **Completeness.** *Reporting should correspond with what it purports to represent. All information should be presented for a user to understand the economic phenomenon being depicted.*

(b) **Yes.** *The company violates the reliability quality by failing to report accumulated depreciation on the face of the balance sheet or in the supporting notes. This reporting policy should be discontinued and the balance of accumulated depreciation should be reported.*

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E 1-49. Elements of Financial Statements

1	g	Equity
2	i	Distributions to owners
3	d	Expenses
	a	Revenues
4	f	Assets
5	d	Expenses
6	a	Revenues
7	b	Losses
	c	Gains
8	e	Liabilities
9	c	Gains
10	h	Investments by owners
11	i	Distributions to owners

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E 1-50. Elements of Financial Statements

a. Sales revenue	Revenue
b. Bonds payable	Liability
c. Cash dividends issued	Distributions to owners
d. Gain on sale of investment	Gain
e. Prepaid insurance	Asset
f. Preferred stock issued for cash	Investments by owners
g. Other comprehensive income	Comprehensive income
h. Advertising expense	Expense
i. Loss on sale of building	Loss
j. Interest payable	Liability
k. Inventory	Asset
l. Retained earnings	Equity

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Income statement
Balance sheet
Statement of stockholders' equity
Income statement
Balance sheet
Statement of stockholders' equity
Statement of comprehensive income
Income statement
Income statement
Balance sheet
Balance sheet
Balance sheet
Statement of stockholders' equity

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E 1-51. Conceptual Framework

a. Revenue recognition criteria
b. Full disclosure
c. Cost effectiveness
d. Assets, liabilities, and equity (defined)
e. Materiality
f. Comparability
g. Revenues and expenses (defined)
h. Monetary unit
i. Verifiability
j. Comprehensive income (defined)
k. Fundamental characteristics
l. To aid in decision-making on resource allocation
m. Enhancing characteristics
n. Provide financial information to investors and
o. Expense recognition
p. Going concern
q. Predictive value
r. Distributions to owners (defined)

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3. Accounting principles
3. Accounting principles
5. Accounting constraint
6. Financial statement elements
2. Qualitative characteristics of financial information
2. Qualitative characteristics of financial information
6. Financial statement elements
4. Accounting assumptions
2. Qualitative characteristics of financial information
6. Financial statement elements
2. Qualitative characteristics of financial information
1. Objective of general-purpose financial reporting
2. Qualitative characteristics of financial information
1. Objective of general-purpose financial reporting
3. Accounting principles
4. Accounting assumptions
2. Qualitative characteristics of financial information
6. Financial statement elements

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E 1-52. Qualitative Characterist

	Concept
a	Comparability
b	Measurement
c	Timeliness
d	Revenue recognition
e	Expense recognition
f	Economic entity
g	Full disclosure

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ics, Principles, Assumptions

Analysis

Violation: Inconsistent application of accounting method.

Violation: The $6,000 implicit interest [($66,000 ÷ 1.10 = $60,000) and ($66,000 - $60,000 = $6,000)] is not a part of the cost of the asset; it is an interest expense for the current period for book purposes.

Violation: statements were issued 9 months after year end. (For example, SEC requires certain filers to report 60 days following the end of the fiscal year.)

Violation: revenue should be recognized when the performance obligation is completed.

Violation: Expense should be record as incurred.

Violation: the company is an identifiable accounting unit.

Violation: Notes and supplemental schedules provide relevant information about the company.

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E 1-53. Principles, Assumptions, Constraint

1	e	Recognition of revenue when performance obligation is met.
2	d	Common denominator—U.S. dollar.
3	g	Expenses recorded as revenue is incurred, as expense is incurred, or systematically over time.
4	i	Preparation cost versus value of benefit to the user.
5	a	Separate and apart from its owners and other entities.
6	h	Report all relevant information.
7	c	Reporting periods—such as monthly, quarterly, or yearly.
8	f	Historical cost and fair value measurements.
9	b	Business continuity for the foreseeable future.

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E 1-54. Principles and Assumptions

1 Monetary unit
2 Full disclosure
3 Going concern
4 Economic entity
5 Expense recognition
6 Expense recognition
7 Periodicity
8 Revenue recognition

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EXERCISES

E 1-55. Principles and Assum

1 Monetary unit
2 Revenue recognition
3 Full disclosure
4 Expense recognition
5 Economic entity
6 Measurement
7 Periodicity
8 Going concern

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ıptions

Under U.S. GAAP currently, financial amounts should not be adjusted for inflation.
Revenue should be recognized when the performance obligation is met.
The impact of a change in accounting principle should be disclosed.
Expense that relates to several periods should be allocated systematically.
The personal assets of the employees should be separate from the corporate entity.
Equipment is recorded at historical cost and is not adjusted to fair value (under GAAP).
Financial statements are reported over a distinct time period of a year.
Allocation of expenses is not supported when the going concern assumption is invalid due to company liquidation.

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AD&J 1-56. Financial Statement Analysis: Evaluating a Change in Accounting Principle

Ford Motor Company adopted a change in accounting for pensions and postretirement employee benefits. The company will now reflect measurement gains and losses immediately in net income, rather than amortizing the impact over time (i.e. Instead of holding the gain or loss in accumulated other comprehensive income).

The gain or loss related to pension plans will affect the income statement immediately which provides more timely information to the users of the financial statements on the expected return of the investments which fund the pension obligations. Previously, investors would have reviewed the OCI statement for disclosure of expected gains or losses (accumulated). This change gives a more complete picture of how the expectations of the investment returns change each period. Also, as Ford stated in the note, the effect on business units is more clear with the change in accounting method.

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AD&J 1-57. Financial Statement Analysis: Evaluating an Annual Report

a. December 31, 2015. Yes
b. $44.294 billion
c. $(1.649) billion
d. $90.093 billion
e. Business and summary of significant accounting policies. 21 notes were provided.
f. Ernst and Young, LLP
g. The following Accounting Standards Updates are discussed:

1. ASU 2014-09, Revenue from Contracts with Customers: The Company is currently evaluating the impact of the update.

2. ASU 2015-02, Amendments to the Consolidation Analysis: The Company does not believe that the adoption of ASU 2015-02 will have a material impact on the Company's financial position, results of operations or cash flows.

3. ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs: The Company expects that the only impact of the adoption of ASU 2015-03 will be the change in balance sheet presentation of our debt issuance costs.

4. ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent): The Company expects that the implementation of this amendment will impact the Company's notes to the consolidated financial statements but will not have an effect on the Company's financial position or results of operations.

5. ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendments in this update simplify the presentation of deferred income taxes and require that deferred tax liabilities and assets be classified as noncurrent in a consolidated statement of financial position. These amendments may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The amendments will be effective for the Company beginning January 1, 2017. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period.

h. It is mentioned indirectly in the report of the Independent Auditors in paragraph 3 (present fairly) and specifically in paragraph one of the Report of Management. The term GAAP is not mentioned directly elsewhere although the results of applying GAAP are found throughout the statements.

i. 1. Intangibles assets with definitive lives are amortized over the expected period benefited principally on the straight-line method for a period of 1 to 20 years. See Note 1.

2. The straight-line method is principally used for depreciation using the estimated useful lives of the assets. See Note 1.
3. Inventory is valued at the lower of cost or market. In general cost is determined using average cost or FIFO. Note 1.

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AD&J 1-58. Communication Case: Conceptual Framework Violations

Case A:
The write-down of the assets is incorrect because there is no justifiable basis for the write-down—the assets have not suffered an impairment of value. The write-down would, if permitted, reduce future depreciation expense, and increase future reported income. However, this write-down is simply an attempt to manipulate future reported income. It violates the relevance and faithful representation characteristics, measurement principle, and expense recognition principle. It also violates the definitions of elements—assets, expenses, earnings and comprehensive income.

Case B:
This case involves a violation of the faithful representation characteristic to a significant degree.
The deliberate understatement of assets and overstatement of liabilities under the guise of conservatism is not acceptable accounting. It would result in understatement of the financial position. Perhaps more serious would be the distortion of income in future years. Acceptable reporting under faithful representation does not justify the use of amounts which are below a reasonable estimate of value for inventory, and it does not permit following arbitrary policies aimed at preventing payment of dividends through understating earnings.

The dividend policy of a company, on the other hand, is a financial management issue and accounting principles do not prohibit a company from following as conservative a policy as they desire in paying dividends. It may be desirable for the company to maintain a strong position by restricting dividend payments, but that is a nonaccounting decision which should be made in light of many factors including future prospects. While the undervaluation of assets does not lose any assets for the company, it does violate the full-disclosure principle. Payment of dividends may weaken a company in some circumstances, but accounting methods should not be distorted because of that possibility.

The use of accounting to smooth out cycles in business by cutting down the peaks of prosperous years and filling up the valleys of depression years is unacceptable. The creation in good years of undisclosed “reserves" which can be utilized in poor years cannot be supported. While future prospects may have some legitimate bearing on certain estimates, such as the provision for loss on accounts, generally guesses as to distant future prospects must be reflected in management policies rather than in accounting policies. The desire of management to protect against future poor prospects can be accomplished by a careful policy of financing, purchasing, plant expansion, etc., but not by misstating current income or financial position.
Over conservatism in accounting by this company may make it more difficult to raise capital or secure loans in the future if, as the problem states, management experiences “hard times."

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AD&J 1-59. Judgment: Evaluation of Intangible Assets

Either position can be argued.

Arguments in favor of inclusion:
a. Provides a more relevant value of the resources committed to the enterprise for the purpose of valuing the company. The alternative is to sell the company.
b. A more relevant measure on which to calculate rate-of-return measures.
c. A more relevant measure to base the calculation of the stockholders' equity.
d. There would be such a discrepancy in asset value on financial statements for a seller of an asset and the buyer of that asset. Financial statements would be more comparable as a result.

Arguments against inclusion:
a. No market-based value or arms'-length transaction to use as a valuation basis.
b. Estimated values are not reliable.
c. Were the company purchased, the value of the trade name would probably differ from this estimated value.

NOTE: GAAP requires a market-established value and, hence, only costs incurred in registering the trademark, legal fees incurred in litigation to defend successfully the trademark, and similar expenditures can be capitalized for internally generated goodwill and brand value, thus often very little is recognized on the balance sheet for these items. However, if one entity purchases these items as part of the purchase of another entity, the purchasing entity can capitalize these values because there would then be a market-established value. Thus, in this case the value reported will be, at most, nominal. Indeed Coca-Cola does not separately report this value.
The instructor should note the student was only asked to guess since this topic is covered in detail in a later chapter.

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AD&J 1-60. Analysis: Alternative Approaches to Setting Accounting Standards

a. Private sector exclusively—setting standards exclusively by the private sector usually is viewed as preferable to governi regulation. However, the accounting profession, because of its independent responsibility to society generally, has been un demonstrate its ability to adequately police itself in all respects.

b. Public sector exclusively—standard setting by legislative action and a centralized agency has the potential to be inflexil bound, making it unacceptable to most parties (preparers, auditors, users, etc.). The approach also makes standard setting v susceptible to lobby efforts (as with the Tax Code).

c. The cooperative joint effort now in existence, with the private sector assuming the primary responsibility, appears to hav acceptance.

The term "political" usually is viewed negatively as a connotation of some undesirable activities observed in the political a setting of accounting standards the term "political process" is used in the context of attaining a consensus when preparers, and users of financial statements negotiate in good faith and in the general interest to resolve their legitimate differences. I premium on accommodating all inputs and logical analysis, and usually involves compromise with the overall societal inte dominating self interests. Some people also raise the problem of lobbying. Lobbying is a fact of life for the FASB. Yet the benefits to lobbying too. In particular, they believe they learn about the issues from those who lobby and who know a lot a costs and problems with applications of the proposed standards. We note that while lobbying exists for FASB it is certainly would be the case if Congress were responsible for standard setting (again, as with the Tax Code).

AD&J 1-61. Judgment: Convergence with International Financial Reporting Standards

The following gains or advantages might accrue:

1. It will be easier to compare financial statements globally. Also, sometimes it is required for subsidiaries in foreign coun convert to IFRS, thus it eliminates the need (and added cost) of maintaining two sets of accounting records.

2. Acquisitions of companies would be less likely to be influenced by different reporting practices. It may be easier for a c raise capital in global markets.

3. Standards would inevitably need to be simpler and more general. (This could be considered either an advantage or disad Simpler standards would be easier, hence also quicker, to promulgate. They would also lead to greater freedom in reportin Achieving the optimal balance between generality and specificity would not be easy.

The following disadvantage might accrue:

1. The U.S. would lose control if standards were made through the IASB (International Accountings Standards Board). Alt U.S. would likely have continual representation on the board, currently, the control of the enactment of changes to the stan with the FASB, with oversight by the SEC.

2. Standards which are more subjective may lead to different interpretations, resulting in less comparability across financia statements.

3. Increase costs in converting to IFRS (short-term).

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AD&J 1-62. Ethical Considerations: Research and Development

We have found that in class it is hard for the student to see the effect on his or her performance evaluation from a manager strongly held beliefs. Hence, they will take the position that the costs should be expensed. The best way to bring out the re issues is for the instructor to role play the manager's position arguing for capitalization based on an expense recognition ar Sometimes we have had luck assigning roles (the new employee, the superior, and the CEO) to students in advance.

A reasonable student position in this case is to point out to the manager that the auditors will require expensing the researc development costs. Then, one could move to arguments the manager or CEO might attempt to use to convince the auditors examples of capitalization of similar items by other companies would be most useful.

The classroom role playing in this case should be hard-nosed if it is to make the ethical dilemma of the student real.

AD&J 1-63. Communication Case: Standard Setting

The position of neutrality articulated by the FASB in its Mission Statement is based on the belief that reporting should be c provide an unbiased, objective and verifiable picture of the firm's results and position. This, they believe, provides the bes information to decision makers.

Others argue that any accounting principle enunciated by the Board inevitably will have economic consequences for the co affected and often for the economy as well. Since the social welfare will be affected, these individuals believe the Board sh consider the potential economic consequences and even, in some cases, draft reporting standards to assist national economi

Arguments against considering these economic consequences rest on the following beliefs. First, the FASB members are n assess the impact over time of a standard on social welfare. Even economists trained in this area have not yet developed a r way of measuring social welfare in simple cases let alone when the consequences are as complex as they would be under a reporting standard. The costs of implementation are difficult enough to judge. Further, standards, once in place, are not eas changed if and when a new one is called for. The process is lengthy.

Second, even if these problems could be overcome, there is a compelling argument that social welfare decisions should be our elected representatives; by Congress, and not by a semi-private body not directly responsible to the people.

A third concern would be the lengthy time an additional mandate (to consider the social welfare of implications of a standa add to an already lengthy process. To do so would likely lead to Congressional intervention even if the economic conseque concern did not. The result could lead to the setting of accounting principles by Congress.

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AD&J 1-64. Analysis: Accrual- and Cash-Basis Accounting

A cash-basis system recognizes transactions at the time, and for the period, when the cash changes hand. Accrual-basis acc
recognizes the transaction when the economic event occurs. Hence, under an accrual-basis system, cash disbursements ma
different time, or in a different period, than the transaction.
Several events, that might be used, are:

		Time of Recognition	
		Cash Basis	Accrual Basis
Revenues			
1.	Credit Sales	Cash Received*	Sale made
2.	Payments for Service	Cash Received*	Service Rendered
Expenses			
1.	Warrantees	Cash paid	Sale made*
2.	Inventories purchased	Cash paid*	Goods Sold

*Denotes the event that occurs first

It is important that the discussion identify the timing issue and note that when different time periods are involved, income
under the accrual and cash basis system.
The key to resolving the apparent discrepancy between the statements is the use in the framework of the word "assessing."
implies a forecasting approach. The position taken by the FASB and others is that accrual-basis accounting, which concent
transactions, provides a sounder basis of forecasting (assessing) future cash flows than a current cash-basis approach.

AD&J 1-65. Reporting Issues: Full Disclosure

a The failure to provide details about the change from FIFO to LIFO violated the full-disclosure principle, the comparabili
(consistency) attribute and the requirement that a change in a major accounting policy must be reported. The results were:
statements are not understandable, (b) they do not faithfully represent what actually happened, (c) they are not comparable
operations, and (d) they are potentially misleading.

b. Full disclosure was violated because the owners' equity section should include another account, Paid-in Capital in Exce
to reflect the $50,000 difference between the par value, $100,000, and the actual cash issue amount, $150,000.

c. Full disclosure and reliability were violated because the $360,000 is gross margin, not revenues. The offset violates the
for complete disclosure of all income statement amounts. The income statement should report the amount of sales revenue
goods sold separately so the user can relate gross margin to sales revenue. For this reporting the financial statements lack r
and reliability and are both incorrect and misleading.

d. The omission of EPS from the income statement violates the full disclosure principle because GAAP require that EPS b
EPS is considered to be essential to full and complete reporting. Failure to report EPS decreases relevance.

e. The offset of current liabilities against current assets seriously violates the full disclosure principle and the qualitative
characteristics of both relevance and reliability. GAAP require that current assets and current liabilities be reported separat
detailed for major items such as cash, inventories, accounts receivable, accounts payable, and wages payable.

f. GAAP require a complete income statement with sufficient detail, including sub classifications, to be understandable, re
not misleading. All relevant items must be reported separately, such as cost of goods sold, expenses, unusual items, incom
extraordinary items. The full disclosure principle was violated.

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AD&J 1-66. Analysis: Comparability, Consistency, and Matching

The improved matching under LIFO comes from matching the most recent costs (the costs of the 'last in') against current r periods of rapidly changing prices, this approach more nearly matches current outlays with current revenues than would a l approach. However, if the other manufacturers continued to use FIFO, it raises a question on why this change back to LIFO made. Comparability (with other manufacturers in the industry) was now being sacrificed for presumed better matching.

AD&J 1-67. Analysis: Qualitative Characteristics

a.
The qualitative characteristic at issue is materiality. Materiality is defined as an item or amount such that the judgment of a reasonable person relying on the information would have been changed or influenced by its omission or misstatement. Imm items must be accounted for, but not in strict conformity with GAAP; they usually are aggregated with other items and amo percent of $2.2 billion appears to be a material amount. At least, most users would probably consider the amount to be mat FASB has not set specific standards for materiality. The FASB justified this on the basis that such standards would be misl unrealistic. In addition, and importantly, fraud losses reported should never be viewed as not material regardless of the amo because fraud itself is always a material item that should be reported (nature of the item).

b.
Similar situations do arise in business. The question is an ethical one. We can easily argue that, as noted in the answer to Requirement a, fraud is always material and should be reported. Certainly the controller should so maintain and point out t president. But suppose despite the best arguments the controller can make, the president continues to insist the item be trea material and even suggests the controller may face termination if the issue is not dropped. Then what should the controller cannot answer for everyone. But we would point out that the controller could bring the matter to the attention of the audito audit committee, or the Board of Directors. If no support is forthcoming, the controller will face the decision alone. Your a hope the controller would insist on disclosure or resign.

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AD&J 1-68. Elements, Principles, Assumptions

Solution

1 Measurement principle
Inventory purchases should be recorded at cost at the time of purchase.
Inventory should have been increased and accounts payable increased at the time of purchase. Then, on the date of payment, cash decreased and accounts payable decreased.

2 Revenue recognition principle
Sale should be recorded when the performance obligation is met--
when the goods are delivered.

3 Expense recognition principle and the definition of an asset:
Ordinary repairs constitute an expense, not an increase to the value of operational assets. Therefore, the company should debit an expense account:

4 Full disclosure principle, the definition of an asset, and faithful representation.
Treasury stock is a contra equity account:
Treasury stock should be reported as a deduction in the stockholders' equity section of the balance sheet and not as an asset.

5 Expense recognition principle and the full disclosure principle.
Depreciation expense should be allocated systematically over the life of the asset and reported on the income statement as an expense.

6 Expense recognition principle and the full disclosure principle.
Income tax expense should be reported on the income statement.

7 Measurement principle.
The sale of stock should be recorded at the fair value of the stock or the fair value of the noncash item, whatever is more easily determinable.

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AD&J 1-69. Codification Skills: Glossary

a. **Fair value.** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

b. **Public business entity.** A public business entity is a business entity meeting any one of the criteria below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.

1. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).

2. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.

3. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.

4. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.

5. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

   An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

c. **Securities and Exchange Commission registrant.** An entity (or an entity that is controlled by an entity) that meets any of the following criteria:

1. It has issued or will issue debt or equity securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).

2. It is required to file financial statements with the Securities and Exchange Commission (SEC).

3. It provides financial statements for the purpose of issuing any class of securities in a public market.

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AD&J 1-70. Codification Skills: Codification References

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