CHAPTER 1
THE ECONOMIC AND INSTITUTIONAL SETTING FOR FINANCIAL REPORTING

CHAPTER OVERVIEW

Financial statements contain information about a company, its economic health, and its products that help users in their decision making, and make it possible to monitor managers' activities. Therein lies the demand for financial statements. Specifically, equity investors, analysts, and brokers use financial statements to form opinions about the value of a company as a basis for their investment decisions or recommendations to others. Creditors use financial information to assess the company's ability to make its debt payments and comply with loan covenants. Auditors use financial statements to help design more effective audits by identifying areas of potential reporting abuses. Other users that demand financial information include managers, employees, suppliers, customers, and government and regulatory agencies. Flexibility and consistency are both desired when preparing financial statements. The changing economic environment demands the revision of standards and best practices that will best serve these two diverse results.

Investors, creditors, and other interested parties demand financial statements because the information is useful. What governs the supply of financial information? Two answers are mandatory reporting and the advantages of voluntary disclosure. Most companies in the U.S. and other developed countries are required to produce, distribute, and file financial reports with a governmental agency—the Securities and Exchange Commission (SEC) in the U.S.—so that interested parties can view the statements. Voluntary financial information that goes beyond the minimum requirements can benefit the company, its managers, and its owners. Voluntary disclosure benefits and costs are likely to affect accounting policies and reporting strategies. Therefore, the flexibility and discretion inherent in financial reporting standards provide managers with opportunities to shape financial statements to achieve specific reporting goals.

Users of this information that understand financial reporting, managers' incentives, and accounting flexibility are better informed and more likely to be able to use financial statements to their advantage in the decision-making process.

The accountant's and analyst's job is more challenging when financial reporting measurement and disclosure rules differ across countries. Those rules may underscore the reporting culture that may have evolved to reflect firms' underlying economic performance. The FASB and IASB are working together to converge U.S. GAAP and IFRS.

CHAPTER OUTLINE

I. WORLDCOM'S CURIOUS ACCOUNTING

A There are several "facts" to consider (stepping back in time to May 2002).

1. The market price of WorldCom is $2.00 per share and declining.
    a. Stock analysts state that WorldCom is doing "surprisingly well despite tough times throughout the industry."
    b. The company has $2.3 billion in cash, which translates into $20.50 book value per share.
2. The first-quarter results indicate sales of $8,120 million and $240 million in pre-tax operating profits – a decline of 16% in sales and 40% in profits while other firms in the industry are reporting even steeper sales and earnings decreases.
3. The company has $104 billion in assets and $44 billion in debt.
4. WorldCom's "line costs" are holding steady at about 42% of sales while other companies are experiencing rising line costs as a percentage of sales.
    a. Does this suggest that WorldCom is adept at managing its excess capacity problems during a period of slack demand?
    b. Is this a cautionary warning signal of problems at the company?
4. You call your broker and find that the stock has declined to $1.75 per share in early trading. What do you do?

II. WHY FINANCIAL STATEMENTS ARE IMPORTANT

Investors need adequate information to judge risk versus reward factors of investment alternatives.

1. A company's financial statements are a critical source of information about the financial condition, operating results, and prospects for the future for an organization.
2. Financial statements can be used as an analytical tool, a management report card, an early warning signal, a basis for prediction, and as a measure of accountability.

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.

A. **Untangling the Web at WorldCom?**

1. An internal audit discovered $3.8 billion in improper transfers of line cost expenses from the income statement to the balance sheet. Without these transfers the company would have reported a loss for 2001 and in the first quarter of 2002.
2. WorldCom stunned investors by announcing that it intended to restate financial statements for 2001 and the first quarter of 2002. .
3. The stock price fell to $.06 per share.
4. Members of management were convicted of fraud and imprisoned.
5. The company defaulted on a $4.25 billion credit line and filed for bankruptcy.
6. The company acknowledged more than $7 billion in accounting errors over the previous years.

Teaching Tip: While fraud is different than the flexibility and discretion inherent in financial reporting rules, analytical review of financial statements may help one uncover fraud.

Teaching Tip: This text does not focus on assisting readers of financial statements in detecting fraud. 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.

III. ECONOMICS OF ACCOUNTING INFORMATION

A. Financial statements serve two key functions:

1. To provide a way for company management to transfer information about business activities to people outside of the company, thereby solving the problem of **information asymmetry** (problem of management having superior information that outsiders)**.**
2. Financial statement information is often included in contracts between the company and other parties since that improves **contract efficiency** (e.g. management compensation contracts).

B. **Demand for Financial Statements -** The supply of financial statement information is guided by the costs of producing and disseminating it and the benefits it will provide to the company. Financial statements are **demanded** because of their value as a source of information about the company's performance, financial condition, and stewardship of its resources. Below is a short list of outsiders whose decisions require financial statement information as a key input in making decisions:

1. **Shareholders and Investors** use financial information to decide on a portfolio consistent with their individual preferences for risk, return, dividend yield, and liquidity.
   a. Financial statements are crucial in **fundamental analysis.**

b. Many analysts look beyond the financial statement numbers to the "meaning behind the numbers," making footnote disclosures invaluable.
c. Shareholders and investors use financial statement information to evaluate the performance of the company's top executives (**stewardship** function of financial reports).

2. **Managers and Employees** use financial information to monitor contracts such as bonus plans, profit-sharing plans, stock ownership plans, and to monitor the health of company-sponsored pension plans along with information that will assist in making decisions concerning the allocation of limited resources.
3. **Lenders and Suppliers** use financial information to assess the financial strength of a business to determine whether to make a loan (or extend credit), and then the amount, interest rate, and security (if any) that is needed.
4. **Customers** use financial information to monitor a supplier's financial health as part of the process of checking out a product and the company that stands behind it.
5. **Government and Regulatory Agencies** demand financial statement information to assess compliance with laws and standards.
   a. Taxing authorities may use financial statement information as a basis for establishing tax policies designed to enhance social welfare.
   b. As customers of businesses, government agencies may use financial statement information to settle contractual payments.
   c. Regulatory intervention may be another source of demand for financial statement information.

C. **Disclosure Incentives and the Supply of Financial Information -** The **supply** of financial information is guided by the costs of producing and disseminating it and the benefits it will provide to the company.

1. Voluntary disclosure occurs so long as the incremental benefits to the company from supplying that information exceed the incremental costs of supplying that information.
   a. Some users, such as creditors, may have enough bargaining power to compel companies to deliver financial information that they need for analysis.
   b. Regulated financial reporting is designed to ensure that companies meet certain minimum levels of financial disclosure and transparency.
2. **Disclosure Benefits**: Owners and managers have an economic incentive to supply the amount and type of financial information that will enable them to raise capital at the lowest cost.
3. **Disclosure Costs:**
   a. Costs associated with collecting, processing, and disseminating financial information can be large.
   b. Competitors may use the information against the company providing the disclosure (competitive disadvantage).
   c. Litigation costs result when financial statement users initiate court actions against the company and its management for financial misrepresentations.
   d. Highly profitable—but politically vulnerable—firms may be subject to political initiatives designed to impose "taxes" on them.

Teaching Tip: Small businesses are often subject to less comprehensive reporting requirements because of the prohibitive costs referred to in (a.) above. Likewise, political costs (d. above) may encourage firms to use accounting methods that appear less profitable. Much of the book is devoted to providing students with the skills necessary to undo accounting methods or to convert from one method to another so that more meaningful comparisons between companies may be made. Therefore, students gain insight into managers' incentives and become more informed readers of financial statements.

IV. A CLOSER LOOK AT PROFESSIONAL ANALYSTS

A. Financial statement users have diverse information needs because they face different decisions or may use different approaches to making the same kind of decision. The conflicting desired result of flexibility and consistency may be problematic to standard setters.

B. The text focuses on "analysts", defined broadly to include investors, creditors, financial advisors, and auditors.

C. **Analysts' Decision -** Information needs of analysts include:

1. Quarterly and annual financial statements and nonfinancial operating and performance data.
2. Management's analysis of financial and nonfinancial data, including reasons for change (management discussion and analysis).
3. Information making it possible to identify future opportunities and risks.
4. Footnotes are important to analysts to obtain a transparent accounting of decision alternates for financial statement comparisons.
5. The analyst needs to be able to compare financial results of diverse companies to help investors decide where to allocate scarce resources.

V. THE RULES OF THE FINANCIAL REPORTING GAME

A. **Generally accepted accounting principles (GAAP)** are a network of conventions, rules, guidelines, and procedures.

1. The goal of GAAP is to ensure that a company's financial statements represent its economic condition and performance.
2. Professional analysts are forward looking. GAAP reports what has occurred.
2. Therefore, analysts must first understand the accounting measurement rules used to produce the data before extrapolating financial statement data into the future.

B. Financial statements should possess certain **qualitative characteristics.**

1. Financial information is **relevant** if it makes a difference in the decision-making process. It is considered relevant if it has both *predictive value* and *confirmatory value.*
2. **Predictive value:** The information improves the decision maker's ability to forecast the future outcome of past or present events.
3. **Confirmatory value:** The information confirms or alters the decision maker's earlier beliefs.
4. Financial information is **timely** if it reaches decision makers before it loses its capacity to influence their decisions.
5. Financial information is **reliable** if it is reasonably free of error and bias, and truthfully represents what it purports to represent.
6. Financial information is **representationally faithful** when the accounting actually represents the underlying transaction or economic event. To achieve faithful representation, the financial information must have the qualities of *completeness* (including all pertinent information), *neutrality* (information cannot be selected to favor one set of interested parties over another), and *free from material error* (Some minimum level of accuracy is necessary for an estimate to be a faithful representation of an economic event).
7. Financial information is **neutral** when it does not favor one set of interested parties over another.
8. Other qualitative characteristics that enhance the decision usefulness and representationally faithful information are *comparability, verifiability, timeliness,* and *understandability.*
9. Financial information is **comparable** when it is measured and reported in a similar manner among different companies.

10. Financial information is **consistent** when the same accounting methods and disclosure practices are used to describe similar events from period to period.
11. **Verifiability** means that independent measurers should get similar results when using the same yardstick.
12. **Timeliness** refers to information that is available to decision makers while it is still capable of influencing their decisions.
13. **Understandability** is the characteristic of information that enables users to comprehend its meaning.

Teaching Tip: Students often want to know which accounting alternative is "best." Qualitative trade-offs make it difficult to identify "good" accounting methods and disclosure practices. For example, market value may be relevant to the decision at hand, but representational faithfulness may be questionable.

C. Two additional conventions affect whether financial statements are complete, understandable, and helpful.
   1. **Materiality** is established when an omission or misstatement is important enough that the judgment of a reasonable person is influenced by the omission or misstatement.
   2. **Conservatism** in accounting involves trying to ensure that business risks and uncertainties are adequately reflected in the financial reports.

D. **Who Determines the Rules?**
   1. The SEC has the ultimate legal authority to determine the rules to be followed in preparing financial statements by publicly traded companies in the Unites States, but has largely delegated its authority to the accounting profession's Financial Accounting Standards Board **(FASB)**.
   2. GAAP may also evolve from accounting practices over time.
   3. The **Public Company Accounting Oversight Board** (PCAOB) was established by the Sarbanes-Oxley Act of 2002 to provide oversight of auditing procedures two ways
      a. establish standards for auditing and ethics at public accounting firms
      b. inspect and investigate auditing practices of public accounting firms
   4. Financial reporting standards outside the U.S. are determined in some countries by professional accounting organizations, in other countries by commercial law and/or tax law requirements, and on a worldwide basis by the **International Accounting Standards Board** (IASB).
   5. A convergence project has a goal of providing one set of worldwide accounting standards to reconcile the IASB standards with those of the FASB.
   6. Due to the voluminous nature of accounting and financial reporting documents, the AICPA in SAS 69 developed a hierarchy for different types of documents.

E. **The Politics of Accounting Standards**: - Standard setting in the U.S. and most other countries is a political and technical process.
   1. Political pressure by interested parties continues to shape the surrounding sensitive and controversial U.S. accounting standards.
   2. While the intensity and frequency of political influence will persist in the future, it is important to remember that accounting standards reflect both:
      a. Sound concepts coupled with independent and objective decision making of standard setters, and
      b. Compromises necessary to ensure that proposed standards are *generally* acceptable.

F. **FASB *Accounting Standards Codification*** TM
   1. The growing number of accounting pronouncements made it difficult to find answers to financial accounting and reporting questions.

2. In 2009, the FASB completed a five-year project to distill the existing GAAP literature into a single database now called the **Accounting Standards Codification** (ASC).
3. The codification does not remove GAAP but reorganizes it for easy accessibility.
4. **ASC Topical Structure and Referencing -** The ASC uses a structure that organizes pronouncements into topics, sections, subsections, and paragraphs.
   i. Topics are the broadest categorization of related guidance and are grouped into four areas: presentation (financial statements or notes); financial statement accounts (such as Receivables, Inventory, etc); broad transactions (e.g. Business combinations and derivatives); and industries (specialized GAAP).
   ii. Subtopics represent subdivisions of a topic and distinguished by type or scope
   iii. Sections are subdivisions such as Recognition, Measurement, or Disclosure

VII. ADVERSARIAL NATURE OF FINANCIAL REPORTING.

1. Managers frequently have reasons to exploit the flexibility and discretion allowed by accounting standards since their interests may conflict with the interests of creditors and shareholders.
2. The flexibility of GAAP financial reporting standards provides opportunities to use accounting “tricks” to make a company appear less risky than it really is, or to “smooth” earnings by strategically timing the recognition of revenues and expenses.

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.

H. Aggressive Financial Reporting: A Case Study - Computer Associates International (CA) embraces aggressive financial reporting practice.

1. **The Accounting Issues:** There are several facts to the case.
   a. This company is a global leader in the software market for managing mainframe and computers networks.
   b. The first accounting controversy regarding revenue recognition occurred when CA changed how it books revenue from software licenses that were renegotiated during the licensing period. The net effect was to double count revenues when the licenses were renegotiated. The impression was given that revenues were increasing over time.
   c. The second accounting controversy stemmed from the company’s decision to roll out a subscription based business model and began reporting results using nonstandard *pro forma* accounting in its earnings announcements.
   d. The differences between the pro forma disclosures and the GAAP numbers were substantial. Under the pro forma disclosure, revenue was reported as $1.284 billion and operating income was $247 million while the GAAP numbers were $783 million for software revenue and operating income was a loss of $342 million.
2. The discrepancy between the pro forma and GAAP numbers made it tough for the investment community to judge the company
3. The Justice Department and the SEC brought suit against CA leading to lawsuits and charges of fraud and obstruction of justice against company executives.

Teaching Tip: Consider breaking the class into small groups and have them discuss the questions posed in the "Questions to Consider" section of this chapter. This may be an excellent way to enforce the need to be consistent with the objectives of financial reporting and the role GAAP plays in meeting those objectives.

I. **Epilog** - CA admitted in October 2003 that some software license contracts had been backdated, to mask declining performance and meet Wall Street forecasts. After an investigation, CA restated $2.2 billion in sales. Company spent $30 million on the investigation. CA agreed to pay $225 million in restitution to shareholders. Top executives are serving prison sentences of up to 12 years each.

J. **Challenges Confronting the Analyst**

A. Financial statements have become increasingly more complex.
B. Service firms and e-commerce companies now represent a major portion of business activities.
C. Global competition for products, services, capital, and customers has introduced yet additional diversity into the financial reporting process.
D. Benefits from increased use and lower cost of technology to assemble and analyze financial data are muted by the increased complexity and dynamic environment in which firms operate

VIII. AN INTERNATIONAL PERSPECTIVE

Countries' reporting philosophy evolves from and reflects the specific legal, political, and financial institutions within the country as well as social customs.

A. Multinational companies shift resources around the world to take advantage of labor markets.
B. Global competition is prevalent in most industries today, and many companies look outside their borders to establish an expanded customer base.
C. Many companies shift resources to take advantage of tax laws and incentives that vary country to country, state to state, and even on a local level.
D. International Standards promulgated by the International Accounting Standards Board (IASB) have had an increasing role in the setting of standards that are consistent throughout the global economy.
E. **Why Do Reporting Philosophies Differ Across Countries?**
The financial reporting philosophies of countries have evolved over many years from the legal, political, and financial institutions, as well as social customs. This evolution creates a business culture, which may determine the informational needs of the various stakeholders (market).
F. Foreign investors and other potential capital providers demand transparent financial reports that reflect the underlying firm economic performance.
G. Sources of financing do shift over time. When this happens, changes in the financial reporting environment occur as well.
H. **Globalization and the Rise of IFRS -** The FASB and the IASB are working toward eliminating differences between U.S. GAAP and IRFS.
I. The SEC permits foreign companies to list their securities on a U.S. stock exchange as long as they are registered with the SEC and use IFRS as a basis for their financial statements. Those firms do not have to reconcile their financial statements to U. S. GAAP.
J. **International Accounting Standards Board (IASB)** – Established by the IASB created in July 1973 with four goals:
    a. To develop a single set of high-quality, understandable, enforceable, and globally accepted international financial reporting standards (IFRS)
    b. To promote the use and rigorous application of those standards
    c. To take account of the financial reporting needs of emerging economies and small and medium-sized entities
    d. To promote and facilitate the adoption of IFRS through the convergence of national accounting standards and IFRS
K. IASB has issued 54 standards and 54 interpretations of the standards. Standards in use in 125 countries worldwide. Compared to U.S. GAAP, IASB standards allow firms more flexibility and more of a

generalized overview approach.

L. Critics of the IASB's **principles-based approach** content that IFRS are so general and the implementation guidance so ambiguous that company managers have excessive latitude in accounting choices.

M. Supporters of the IFRS argue that rigidity is less with IFRS where there are broad principles and not as detailed as in **rules-based U.S. GAAP approach**.

N. **The March Toward Convergence:** Cross-border comparisons are difficult without convergence. Some success on convergence has been achieved but some important differences still remain such as:
   a. *Reversal of inventory write-downs*
   b. *Extraordinary items*
   c. *Research and development costs*

IX. Appendix—GAAP IN THE UNITED STATES

A. **Early Developments:** Corporate financial reporting in the U.S. prior to 1900 were primarily intended to provide accounting information for management's use. The NYSE, established in 1792, was the primary mechanism for trading ownership in corporations. The securities trading ups and downs led to the need for a standardized accounting policies and practices to be followed by SEC registered companies.

B. **Emergence of GAAP -** The Securities Act of 1933 required companies selling publicly traded stock and debt to provide financial information.
   1. The Act was amended in 1934 to create the Securities and Exchange Commission (SEC).
   2. Firms with stock or debt listed on organized exchanges were required to file annual financial reports with the SEC.

B. The American Institute of Certified Public Accountants (AICPA) Committee on Accounting Procedures issued bulletins between 1938 and 1959 that set forth the framework for what the committee believed to be generally accepted accounting procedures.

C. In 1959, the AICPA established the Accounting Principles Board (APB) to develop a conceptual framework and to issue statements to improve external financial reporting and disclosure.
   1. The force of these pronouncements depended on general acceptance and persuasion.
   2. Critics cited numerous instances where net income could be manipulated by selecting among several methods that were "generally accepted."

D. The Financial Accounting Standards Board (FASB) was created in 1973. It differed from its predecessors in several important ways.
   1. There were seven board members (APB had eighteen).
   2. All Board members were required to sever ties with their previous employer.
   3. Broader representation was achieved since board members did not have to be Certified Public Accountants (CPA).
   4. Staff support was increased substantially.

E. **Current Institutional Structure in the United States:** The SEC still retains broad statutory powers over financial reporting practices, but continues to rely on private sector organizations (currently the FASB) to set accounting standards.
   1. The FASB has no authority to enforce compliance with generally accepted accounting principles (GAAP). That responsibility lies with management, the accounting profession, the SEC, and the courts.
   2. The FASB follows a "due process" procedure in developing Accounting Standards updates. Most updates issued by the FASB go through three steps:
      a. *Discussion-memorandum stage* outlines the key issues involved.

b. *Exposure-draft stage* encourages further public comment that is evaluated. c. *Voting stage* is when the Board votes whether to issue an ASU describing amendments to the Accounting Standards Codification or to revise the proposed update and reissue a new exposure draft.

3. **Public Company Accounting Oversight Board:** The Public Company Accounting Oversight Board (PCAOB) has a role in developing transparent financial statement and an increased system of internal control. The PCAOB regulates accounting firms auditing companies that are listed on public exchanges
4. **Sox Compliance:** The Sarbanes-Oxley Act (SOX) was enacted to reign in accounting abuses by strengthening auditor independence and improving financial reporting transparency.
   a. CEOs and CFOs must certify the accuracy of financial statements
   b. An annual evaluation of internal controls and procedures must be conducted.

CHAPTER QUIZ

1. During a period when a firm is under the direction of particular management, its financial statements will directly provide information about:
   a. Both firm performance and management performance.
   b. Management performance but not directly provide information about firm performance.
   c. Firm performance but not directly provide information about management performance.
   d. Neither firm performance nor management performance.

2. Which of the following statements reflects the basic purpose of financial reporting?
   a. The primary focus of financial reporting is information about a firm's resources.
   b. The best indication of a firm's ability to generate favorable cash flow information is based on
   previous cash receipts and payments.
   c. Financial accounting is expressly designed to directly measure the value of a firm.
   d. Investment and credit decisions often are based, at least in part, on evaluations of the past
   performance of an enterprise.

3. Which of the following is considered a pervasive constraint under generally accepted accounting principles?
   a. Benefits/costs.
   b. Conservatism.
   c. Timeliness.
   d. Verifiability.

4. According to the FASB conceptual framework, the qualitative characteristic of neutrality is an ingredient of:

	Faithful Representation	Relevance
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

5. According to the FASB conceptual framework, which of the following situations violates the qualitative characteristic of faithful representation?
   a. Financial statements were issued nine months late.
   b. Data on business segments having the same expected risks and growth rates are reported to analysts estimating future profits.
   c. Financial statements included property reported at an increased amount that reflects management's estimate of market value.
   d. Management reports to stockholders regularly refer to new projects undertaken, but the financial statements never report project results.

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 the audit of the financial statements?
   a. Political cost
   b. Litigation cost.
   c. Information collection and dissemination cost.
   d. Competitive disadvantage 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. According to the FASB conceptual framework, the objectives of financial reporting are based on
    a. The need for conservatism.
    b. Reporting on management's stewardship and performance.
    c. Generally accepted accounting principles.
    d. The needs of the users of the information.

Essay Question

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?

QUIZ ANSWERS:

1. c. Financial reporting provides information about an enterprise's performance during a period, but *does not* separate the effect of a particular management's performance from the effects of prior management actions, general economic conditions, the supply and demand for an enterprise's inputs and outputs, price changes, and other events.
2. d. Although investment and credit decisions reflect expectations about future performance, those expectations are based, in part, on evaluations *of past* performance.
3. a. All accounting information is subject to two qualitative constraints: materiality and cost/benefit. The cost/benefit constraint states that benefits of information must exceed the cost of obtaining it.
4. b. Faithful representation assures that information is reasonably free from error and bias and faithfully represents what it purports to represent. Its ingredients are completeness, verifiability, and neutrality. Neutrality is the absence of bias intended to reach a predetermined result or induce a certain behavior.
5. c. Faithful representation is defined as the quality of information that provides assurance that the information is reasonably free from error and bias. In accordance with GAAP, the carrying value of property should not be increased to market value.
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. a. Managers and employees use financial information to monitor employee contracts such as bonus plans, profit–sharing plans, and pension plans.
8. c. Audit costs are associated with information collection and dissemination costs.
9. c. The FASB is charged with the responsibility of establishing financial accounting standards.
10. d. According to the conceptual framework, one objective of financial reporting is to provide information that is useful to present and potential investors, creditors, and other users in making investment, credit, and similar decisions.

RECOMMENDED EXHIBITS

1. Figure 1.2—Desirable Characteristics of Accounting Information

SUGGESTED READINGS

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