

## CA 1-1

- (a) Financial accounting is the process that culminates in the preparation of financial reports relative to the enterprise as a whole for use by parties both internal and external to the enterprise. In contrast, managerial accounting is the process of identification, measurement, accumulation, analysis, preparation, interpretation, and communication of financial information used by the management to plan, evaluate, and control within an organization and to assure appropriate use of, and accountability for, its resources.
- (b) The financial statements most frequently provided are the balance sheet, the income statement, the statement of cash flows, and the statement of changes in owners' or stockholders' equity.
- (c) Financial statements are the principal means through which financial information is communicated to those outside an enterprise. As indicated in (b), there are four major financial statements. However, some financial information is better provided, or can be provided only, by means of financial reporting other than formal financial statements. Financial reporting (other than financial statements and related notes) may take various forms. Examples include the company president's letter or supplementary schedules in the corporate annual reports, prospectuses, reports filed with government agencies, news releases, management's forecasts, and descriptions of an enterprise's social or environmental impact.

## CA 1-2

- (a) In accordance with **Statement of Financial Accounting Concepts No. 1**, "Objectives of Financial Reporting by Business Enterprises," the objectives of financial reporting are to provide information to investors, creditors, and others
  1. that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
  2. to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.
  3. about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.
- (b) **Statement of Financial Accounting Concepts No. 1** established standards to meet the information needs of large groups of external users such as investors, creditors, and their representatives. Although the level of sophistication related to business and financial accounting matters varies both within and between these user groups, users are expected to possess a reasonable understanding of accounting concepts, financial statements, and business and economic activities and are expected to be willing to study and interpret the information with reasonable diligence.

## CA 1-4

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

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

## CA 1-6

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

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

- (b) The FASB issues three major types of pronouncements: Standards and Interpretations, Financial Accounting Concepts, and Technical Bulletins. Financial accounting standards issued by the FASB are considered GAAP. In addition, the FASB also issues interpretations that represent modifications or extensions of existing standards and APB Opinions. These interpretations have the same authority as standards and APB Opinions in guiding current accounting practices.

The Statements of Financial Accounting Concepts (SFAC) help the FASB to avoid the "problem-by-problem approach." These statements set forth fundamental objectives and concepts that the Board will use in developing future standards of financial accounting and reporting. They are intended to form a cohesive set of interrelated concepts, a body of theory or a

conceptual framework, that will serve as tools for solving existing and emerging problems in a consistent, sound manner.

The FASB may issue a technical bulletin when there is a need for guidelines on implementing or applying FASB Standards or Interpretations, APB Opinions, Accounting Research Bulletins, or emerging issues. A technical bulletin is issued only when (1) it is not expected to cause a major change in accounting practice for a number of enterprises, (2) its cost of implementation is low, and (3) the guidance provided by the bulletin does not conflict with any broad fundamental accounting principle.

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

## CA 1-8

- (a) The public/private mixed approach appears to be the way rules are established in the United States. In many respects, the FASB is a quasi-governmental agency in that its pronouncements are required to be followed because the SEC has provided support for this approach. The SEC has the ultimate power to establish GAAP but has chosen to permit the private sector to develop these rules. By accepting the standards established by the FASB as authoritative, it has granted much power to the FASB. (It might be useful to inform the students that not all countries follow this model. For example, the purely political approach is used in France and West Germany. The private, professional approach is employed in Australia, Canada, and the United Kingdom.)
- (b) Publicly reported accounting numbers influence the distribution of scarce resources. Resources are channeled where needed at returns commensurate with perceived risk. Thus, reported accounting numbers have economic effects in that resources are transferred among entities and individuals as a consequence of these numbers. It is not surprising then that individuals affected by these numbers will be extremely interested in any proposed changes in the financial reporting environment.
- (c) The Accounting Standards Executive Committee (AcSEC of the AICPA), among other groups, has presented a potential challenge to the exclusive right of the FASB to establish accounting principles. Also, Congress has been attempting to legislate certain accounting practices, particularly to help struggling industries.

Some possible reasons why other groups might wish to establish GAAP are:

1. As indicated in the previous answer, these rules have economic effects and therefore certain groups would prefer to make their own rules to ensure that they receive just treatment.
2. Some believe the FASB does not act quickly to resolve accounting matters, either because it is not that interested in the subject area or because it lacks the resources to do so.
3. Some argue that the FASB does not have the competence to legislate GAAP in certain areas. For example, many have argued that the FASB should not legislate GAAP for

not-for-profit enterprises because the problems are unique and not well known by the FASB.

### **CA 1-10**

1. (b), (e)
2. (a)
3. (c)
4. (d)

### **CA 1-11**

1. (d)
2. (f)
3. (c)
4. (e)
5. (a)
6. (b)