

## Chapter 1

### Introduction to Financial Reporting

#### QUESTIONS

- 1- 1.
- a. The AICPA is an organization of CPAs that prior to 1973 accepted the primary responsibility for the development of generally accepted accounting principles. Their role was substantially reduced in 1973 when the Financial Accounting Standards Board was established. Their role was further reduced with the establishment of the Public Company Accounting Oversight Board was established in 2002.
  - b. The Financial Accounting Standards Board replaced the Accounting Principles Board as the primary rule-making body for accounting standards. It is an independent organization and includes members other than public accountants.
  - c. The SEC has the authority to determine generally accepted accounting principles and to regulate the accounting profession. The SEC has elected to leave much of the determination of generally accepted accounting principles to the private sector. The Financial Accounting Standards Board has played the major role in establishing accounting standards since 1973. Regulation of the accounting profession was substantially turned over to the Public Company Accounting Oversight Board in 2002.
- 1- 2. Consistency is obtained through the application of the same accounting principle from period to period. A change in principle requires statement disclosure.
- 1- 3. The concept of historical cost determines the balance sheet valuation of land. The realization concept requires that a transaction needs to occur for the profit to be recognized.
- 1- 4.
- a. Entity
  - b. Realization
  - c. Materiality
  - d. Conservatism
  - e. Historical cost
  - f. Historical cost
  - g. Disclosure
- 1- 5. Entity concept

- 1- 6. Generally accepted accounting principles do not apply when a firm does not appear to be a going concern. If the decision is made that this is not a going concern, then the use of GAAP would not be appropriate.
- 1- 7. With the time period assumption, inaccuracies of accounting for the entity, short of its complete life span, are accepted. The assumption is made that the entity can be accounted for reasonably accurately for a particular period of time. In other words, the decision is made to accept some inaccuracy because of incomplete information about the future in exchange for more timely reporting. The statements are considered to be meaningful because material inaccuracies are not acceptable.
- 1- 8. It is true that the only accurate way to account for the success or failure of an entity is to accumulate all transactions from the opening of business until the business eventually liquidates. But it is not necessary that the statements be completely accurate in order for them to be meaningful.
- 1- 9. a. A year that ends when operations are at a low ebb for the year.  
b. The accounting time period is ended on December 31.  
c. A twelve-month accounting period that ends at the end of a month other than December 31.
- 1-10. Money.
- 1-11. When money does not hold a stable value, the financial statements can lose much of their significance. To the extent that money does not remain stable, it loses usefulness as the standard for measuring financial transactions.
- 1-12. No. There is a problem with determining the index in order to adjust the statements. The items that are included in the index must be representative. In addition, the prices of items change because of various factors, such as quality, technology, and inflation.  
  
Yes. A reasonable adjustment to the statements can be made for inflation.
- 1-13. False. An arbitrary write-off of inventory cannot be justified under the conservatism concept. The conservatism concept can only be applied where there are alternative measurements and each of these alternative measurements has reasonable support.
- 1-14. Yes, inventory that has a market value below the historical cost should be written down in order to recognize a loss. This is done based upon the concept of conservatism. Losses that can be reasonably anticipated should be taken in order to reflect the least favorable effect on net income of the current period.

1-15. End of production

The realization of revenue at the completion of the production process is acceptable when the price of the item is known and there is a ready market.

Receipt of cash

This method should only be used when the prospects of collection are especially doubtful at the time of sale.

During production

This method is allowed for long-term construction projects because recognizing revenue on long-term construction projects as work progresses tends to give a fairer picture of the results for a given period in comparison with having the entire revenue realized in one period of time.

1-16. It is difficult to apply the matching concept when there is no direct connection between the cost and revenue. Under these circumstances, accountants often charge off the cost in the period incurred in order to be conservative.

1-17. If the entity can justify the use of an alternative accounting method on the basis that it is rational, then the change can be made.

1-18. The accounting reports must disclose all facts that may influence the judgment of an informed reader. Usually this is a judgment decision for the accountant to make. Because of the complexity of many businesses and the increased expectations of the public, the full disclosure concept has become one of the most difficult concepts for the accountant to apply.

1-19. There is a preference for the use of objectivity in the preparation of financial statements, but financial statements cannot be completely prepared based upon objective data; estimates must be made in many situations.

1-20. This is a true statement. The concept of materiality allows the accountant to handle immaterial items in the most economical and expedient manner possible.

1-21. Some industry practices lead to accounting reports that do not conform to generally accepted accounting principles. These reports are considered to be acceptable, but the accounting profession is making an effort to eliminate particular industry practices that do not conform to the normal generally accepted accounting principles.

1-22. Events that fall outside of the financial transactions of the entity are not recorded. An example would be the loss of a major customer.

- 1-23. True. The accounting profession is making an effort to reduce or eliminate specific industry practices.
- 1-24. The entity must usually use the accrual basis of accounting. Only under limited circumstances can the entity use the cash basis.
- 1-25. The FASB commenced the Accounting Standards Codification™ project to provide a single source of authoritative U.S. GAAP and provide one level of authoritative GAAP.
- 1-26. The separate entity concept directs that personal transactions of the owners must be kept separate from their business transactions.
- 1-27. At the point of sale
- 1-28. a. The building should be recorded at cost, which is \$50,000.  
b. Revenue should not be recorded for the savings between the cost of \$50,000 and the bid of \$60,000. Revenue comes from selling, not from purchasing.
- 1-29. The materiality concept supports this policy.
- 1-30. The Securities and Exchange Commission (SEC).
- 1-31. The basic problem with the monetary assumption when there has been significant inflation is that the monetary assumption assumes a stable dollar in terms of purchasing power. When there has been inflation, the dollar has not been stable in terms of purchasing power, and therefore, dollars are being compared that are not of the same purchasing power.
- 1-32. The matching principle deals with the costs to be matched against revenue. The realization concept has to do with the determination of revenue. The combination of revenue and costs determine income.
- 1-33. The term "generally accepted accounting principles" is used to refer to accounting principles that have substantial authoritative support.
- 1-34. The process of considering a Statement of Financial Accounting Standards begins when the Board elects to add a topic to its technical agenda. The Board only considers topics that are "broken" for its technical agenda.

On projects with a broad impact, a Discussion Memorandum or an Invitation to Comment is issued. The Discussion Memorandum or Invitation to Comment is distributed as a basis for public comment. After considering the written comments and the public hearing comments, the Board resumes deliberations in one or more public Board meetings. The final Statement on

Financial Accounting Standards must receive a majority affirmative vote of the Board.

- 1-35. The FASB Conceptual Framework for Accounting and Reporting is intended to set forth a system of interrelated objectives and underlying concepts that will serve as the basis for evaluating existing standards of financial accounting and reporting.
- 1-36. a. A committee of the AICPA that played an important role in the determination of generally accepted accounting principles in the United States between 1939 and 1959.
- b. A committee of the AICPA that played an important role in the defining of accounting terminology between 1939 and 1959.
- c. An AICPA board that played a leading role in the development of generally accepted accounting principles in the United States between 1959 and 1973.
- d. The Board that has played the leading role in the development of generally accepted accounting principles in the United States since 1973.
- 1-37. Concepts Statement No. 1 indicates that the objectives of general-purpose external financial reporting are primarily for the needs of external users who lack the authority to prescribe the information they want and must rely on information management communicates to them.
- 1-38. Financial accounting is not designed to measure directly the value of a business enterprise. Concepts Statement No. 1 indicates that financial accounting is not designed to measure directly the value of a business enterprise, but the information it provides may be helpful to those who wish to estimate its value.
- 1-39. According to Concepts Statement No. 2, to be relevant, information must be timely and it must have predictive value or feedback value, or both. To be reliable, information must have representational faithfulness and it must be verifiable and neutral.
- 1-40. 1. Definition  
2. Measurability  
3. Relevance  
4. Reliability

- 1-41.     1. Historical cost  
          2. Current cost  
          3. Current market value  
          4. Net realizable value  
          5. Present value
- 1-42.     The accrual basis income statement recognizes revenue when it is realized (realization concept) and expenses recognized when they are incurred (matching concept). The cash basis recognizes revenue when the cash is received and expenses when payments are made.
- 1-43.     True. Usually the cash basis does not indicate when the revenue was earned and when the cost should be recognized. The cash basis recognizes cash receipts as revenue and cash payments as expenses.
- 1-44.     When cash is received and when payment is made is important. For example, the timing of cash receipts and cash payments can have a bearing on a company's ability to pay bills on time.
- 1-45.     Sarbanes-Oxley Section 404 requires companies to document adequate internal controls and procedures for financial reporting. They must be able to assess the effectiveness of the internal controls and financial reporting.
- 1-46.     The financial statements auditor must report on management's assertion as to the effectiveness of the internal controls and procedures as of the company's year end.
- 1-47.     There have been many benefits for implementing Sarbanes-Oxley. Companies have improved their internal controls, procedures, and financial reporting. Many companies have improved their fraud prevention. Systems put in place to review budgets will enable companies to be more proactive in preventing problems and improve their ability to be proactive. Users of financial statements benefit from an improved financial product that they review and analyze to make investment decisions.
- 1-48.     Private companies are not required to report under Sarbanes-Oxley.
- 1-49.     In many instances, the natural business year of a company ends on December 31. Other businesses use the calendar year and thus end the accounting on December 31. For a fiscal year, the accounting period closes at the end of a month other than December.
- 1-50.     *Accounting Trends & Techniques* is a compilation of data obtained by a survey of 600 annual reports to stockholders undertaken for the purpose of analyzing the accounting information disclosed in such reports.

- 1-51. The Sarbanes-Oxley Act of 2002 has put demands on management to detect and prevent material control weaknesses in a timely manner.
- 1-52. The PCAOB is the private sector corporation created by the Sarbanes-Oxley Act of 2002. They are responsible for overseeing the audits of public companies. They have broad authority over public accounting firms and auditors. Their actions are subject to the approval of the Securities and Exchange Commission.
- 1-53. The Serious concerns were about the cost of adoption, the benefits of adoption compared to convergence, and whether IFRS were in fact as good as or better than U.S. GAAP.
- 1-54. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) met jointly in Norwalk, Connecticut on September 18, 2002. They acknowledge their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting (this is known as the Norwalk Agreement).
- 1-55. The American Accounting Association Committee on Financial Reporting Policy concluded that eliminating the reconciliation in requirements was premature. Several of their points follow:
1. Material reconciling items exist between U.S. GAAP and IFRS and the reconciliation currently reflects information that participants in U.S. stock markets appear to impound to stock prices.
  2. Cross-country institutional differences will likely result in differences in the implementation of any single set of standards.
  3. Legal and institutional obstacles inhibit private litigation against foreign firms in the United States and the SEC rarely undertakes enforcement actions against cross-listed firms.
  4. Differential implementation of standards across countries and a differential enforcement efforts directed toward domestic and cross-listed firms creates differences in financial reporting even with converged standards.
  5. Harmonization appears to be occurring via the joint standard-setting activities of the FASB and the IASB; thus, special statutory intervention by the SEC appears to be unnecessary.
- 1-56. Professor Ball noted these problems with implementing IFRS:
1. On the con side, a deep concern is that the differences in financial reporting quality that are inevitable among countries have been pushed down to the level of implementation and now will be concealed by a veneer of uniformity.
  2. Despite increased globalization, most political and economic influences on financial reporting practice remain local.

3. The fundamental reason for being skeptical about uniformity of implementation in practice is that the incentives of preparers and enforcers remain primarily local.
  4. Under its constitution, the IASB is a standard setter and does not have an enforcement mechanism for its standards.
  5. Over time the IASB risks becoming a politicized, polarized, bureaucratic on-style body.
- 1-57. 2009. The issue of SMEs is not part of the roadmap of convergence between IFRSs and U.S. GAAP.



PROBLEMS

PROBLEM 1-1

- |                 |                  |                  |                  |
|-----------------|------------------|------------------|------------------|
| 1. <u>  a  </u> | 6. <u>  d  </u>  | 11. <u>  l  </u> | 16. <u>  g  </u> |
| 2. <u>  r  </u> | 7. <u>  f  </u>  | 12. <u>  m  </u> | 17. <u>  e  </u> |
| 3. <u>  o  </u> | 8. <u>  h  </u>  | 13. <u>  p  </u> | 18. <u>  c  </u> |
| 4. <u>  q  </u> | 9. <u>  i  </u>  | 14. <u>  n  </u> | 19. <u>  s  </u> |
| 5. <u>  b  </u> | 10. <u>  j  </u> | 15. <u>  k  </u> |                  |

PROBLEM 1-2

|    |                                  |                  |
|----|----------------------------------|------------------|
| a. | Sales on credit                  | \$ 80,000        |
|    | Cost of inventory sold on credit | (65,000)         |
|    | Payment to sales clerk           | <u>(10,000)</u>  |
|    | Income                           | <u>\$ 5,000</u>  |
|    |                                  |                  |
| b. | Collections from customers       | \$ 60,000        |
|    | Payment for purchases            | (55,000)         |
|    | Payment to sales clerk           | <u>(10,000)</u>  |
|    | Loss                             | <u>\$(5,000)</u> |

PROBLEM 1-3

- a.   1   Statements of Position have been issued by the AICPA.
- b.   2   This is the definition contained in SFAC No. 6
- c.   2   This is the definition contained in SFAC No. 6.
- d.   5   Comparability is not one of the criteria for an item to be recognized.
- e.   2   Future cost is not one of the measurement attributes recognized in SFAC No. 5.
- f.   1   Revenue is usually recognized at point of sale.
- g.   1   Financial accounting is not designed to measure directly the value of a business enterprise.

PROBLEM 1-4

- a. 2 Typically, much judgment and estimates go into the preparation of financial statements.
- b. 4 Financial accounting is not designed to measure directly the value of a business enterprise. The end result statements can be used as part of the data to aid in estimating the value of the business.
- c. 4 FASB Statement of Concepts No. 2 lists timeliness, predictive value, and feedback value as ingredients of the quality of relevance.
- d. 2 The Securities and Exchange Commission has the primary right and responsibility for generally accepted accounting principles. They have primarily elected to have the private sector develop generally accepted accounting principles and have designated the Financial Accounting Standards Board as the primary source.
- e. 4 The concept of conservatism directs that the measurement with the least favorable effect on net income and financial position in the current period be selected.
- f. 3 The Internal Revenue Service deals with Federal tax law, not generally accepted accounting principles.
- g. 5 Opinions were issued by The Accounting Principles Board.

PROBLEM 1-5

- |             |              |              |
|-------------|--------------|--------------|
| 1. <u>o</u> | 6. <u>e</u>  | 11. <u>h</u> |
| 2. <u>a</u> | 7. <u>f</u>  | 12. <u>k</u> |
| 3. <u>b</u> | 8. <u>j</u>  | 13. <u>c</u> |
| 4. <u>l</u> | 9. <u>i</u>  | 14. <u>m</u> |
| 5. <u>d</u> | 10. <u>g</u> | 15. <u>n</u> |

PROBLEM 1-6

- |             |             |             |             |             |
|-------------|-------------|-------------|-------------|-------------|
| 1. <u>b</u> | 3. <u>h</u> | 5. <u>d</u> | 7. <u>e</u> | 9. <u>g</u> |
| 2. <u>a</u> | 4. <u>c</u> | 6. <u>i</u> | 8. <u>f</u> |             |

## CASES

### CASE 1-1 STANDARD-SETTING: "A POLITICAL ASPECT"

(This case provides an opportunity to view some of the political aspects of standard setting.)

- a. The hierarchy of accounting qualities in SFAC No. 2 includes neutrality as one of the ingredients. SFAC No.2 indicates that, to be reliable, the information must be verifiable, subject to representational faithfulness, and neutral.

To quote from the Beresford letter: "If financial statements are to be useful, they must report economic activity without coloring the message to influence behavior in a particular direction."

- b. Costs of transactions do exist whether or not the FASB mandates their recognition in financial statements. The markets may not be able to recognize these costs in the short run if they are not reported. Thus investors, creditors, regulators, and other users of financial reports may not be able to make reasonable business and economic decisions if the costs are not reported.
- c. Much of the standard setting in the U.S. is in the private sector. A major role in the private sector has been played by The American Institute of Certified Public Accountants. Since 1973 the primary role in the private sector has been played by The Financial Accounting Standards Board.

It should be noted that the Securities Act of 1934 gave the SEC the authority to determine generally accepted accounting principles and to regulate the accounting profession. The Beresford letter recognizes that the SEC and congressional committees maintain an active oversight of the FASB.

- d. True. Quoting from the letter: "We expect that changes in financial reporting will have economic consequences, just as economic consequences are inherent in existing financial reporting practices."

## CASE 1-2 POLITICIZATION OF ACCOUNTING STANDARDS – A NECESSARY ACT?

(This case addresses the role of the Emergency Economic Stabilization Act of 2008 and the subsequent role of the SEC and the FASB).

a. This is an opinion question:

A review of the accounting standard was likely justified considering the economic situation. Should the review have been done by the SEC or FASB independently of congress?

b. Yes. The SEC has the authority to govern GAAP in the U.S. A case could be made that the SEC should have acted sooner.

c. As indicated in (b), the SEC has the authority to govern GAAP.

d. No. The time frame was very short.

e. Probably not. In the long run, the involvement of congress is likely to be negative.

## CASE 1-3 INDEPENDENCE OF ACCOUNTING STANDARD-SETTERS

(This case provides a forum to discuss the independence of accounting standard-setters. The timing of this case (December 2008) was during the period when congress was putting pressure on the SEC and the FASB to address the standard for fair value accounting). Some politicians and others thought that a standard change was needed to avert material write down of investments by financial institutions).

a. Standard setters have traditionally resisted using accounting standards as a fiscal policy tool. Standard setters have tried to use standards as a neutral and objective measurement of the financial performance of public companies.

b. Should the deliberative process be waived when a national emergency exists in the financial system?

Note: In an Op Ed in the Washington Post, author A. Levitt, a former SEC chair, clearly disapproved of FASB's expedited due process for new fair value guidance in FAS 157-e.

### CASE 1-4 LOOKING OUT FOR INVESTORS

(The SEC plays an important role in “Looking Out for Investors.” This case provides an opportunity to discuss that role).

- a. Mary Schapiro addresses some of the cost of over-regulation as stifling of innovation and the superior ability of markets to protect themselves from excess. Over regulation will be costly for businesses because compliance costs tend to be high and compliance sometimes takes time to put those controls into place e.g. internal controls related to Sarbanes-Oxley.
- b. Under-regulation can result in inefficient capital markets. To ensure that capital markets are efficient, Mary Schapiro indicates that the SEC will approach this in four ways as follows:
  1. First, structured effectively
  2. Second, that they’re fed by timely and reliable information
  3. Third, that they’re well-served by financial intermediaries and other market professionals
  4. And fourth, that they’re supported by a strong and focused enforcement arm that will not be afraid to prosecute securities fraud.
- c. This is an opinion question.

### CASE 1-5 FLYING HIGH

(This is a good case to discuss revenue recognition and compare program accounting with the percentage of completion and completed contract method of revenue recognition used by contractors.)

- a. It would be difficult to separate contracts that contain provisions to earn incentive and award fees that can be reasonably estimated from contracts that cannot be reasonably estimated.
- b. It appears that Boeing Company is using a completed contract method for commercial airplanes. It does not represent a difficult situation in determining sales, but sales may not be representative of the production for any particular time period. They are estimating costs of sales while sales are based on deliveries.
- c. It is probably not difficult to determine service revenue. The service likely does not represent a long period of time.
- d. It should not be difficult to determine revenue from notes receivable. The terms of the notes would be objective.

### CASE 1-6 CENTERED IN HAWAII

(This is a good case to discuss revenue recognition.)

- a. “In general, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery of the service or product has occurred, the sales price is fixed or determinable, and collectability is reasonably assured.

- b. Voyage Revenue Recognition.

Yes, this could represent a challenge of matching cost with revenue.

We likely have a situation here where expenses are incurred approximately at the same rate as the recognition of revenue.

- c. Yes.

Appears to be a type of percentage-of-completion method.

- d. 1. Generally on closing date, “adequate initial and continuing investments have been received and collection of remaining balances, if any, is reasonably assured.

2. Percentage-of-completion method.

Used when there is material continuing post-closing involvement.

- e. In general, recognizing revenue as rent over the time of the lease.

For revenue related to contingent sales, the revenue is recognized only after the contingency has been resolved.

### CASE 1-7 GOING CONCERN?

- a. The going-concern assumption is that the entity in question will remain in business for an indefinite period of time.
- b. Yes. The potential problem is that the firm may not be able to continue in business as a going concern. This puts into question the recoverability and classification of assets or the amounts and classification of liabilities.
- c. This disclosure puts the user of the statements on warning that the statements may be misleading if the company cannot continue as a going concern.

## CASE 1-8 ECONOMICS AND ACCOUNTING: THE UNCONGENIAL TWINS

a. No. Per Kenneth E. Boulding:

"Ritual is always the proper response when a man has to give an answer to a question, the answer to which he cannot really know. Ritual under these circumstances has two functions. It is comforting (and in the face of the great uncertainties of the future, comfort is not to be despised) and it is also an answer sufficient for action."

b. No. Per Kenneth E. Boulding:

"The wise businessman will not believe his accountant although he takes what his accountant tells him as important evidence. The quality of that evidence, however, depends in considerable degree on the simplicity of the procedures and the awareness which we have of them."

c. Per Kenneth E. Boulding:

"It is the sufficient answer rather than the right answer which the accountant really seeks."

Boulding indicates that accounting does not need to be accurate in order to serve a useful function. The financial statements does not attest that they are correct only that they are presented fairly in accordance with generally accepted accounting principles.

## CASE 1-9 I OFTEN PAINT FAKES

(This case is intended to serve as a forum for discussing the accuracy of financial statements prepared using generally accepted accounting principles.)

- a. Accounting reports prepared using generally accepted accounting principles are not exactly accurate. They are intended to be sufficient to aid in making informed decisions. Reports are only as good as the underlying numbers. If numbers are not reliable, then it doesn't matter if GAAP is properly applied.
- b. No, accountants do not paint fakes. But, it may take an understanding of generally accepted accounting principles to reasonably comprehend the significance of the statements.

## CASE 1-10 OVERSIGHT

(This case reviews selected sections of the Sarbanes-Oxley Act.)

- a. Securities and Exchange Commission
- b. The Securities and Exchange Commission oversees the Public Company Accounting Oversight Board.
- c. The Public Company Accounting Oversight Board oversees the audits and related matters of public companies that are subject to the securities laws, and related matters. The intent is to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies, the securities of which are sold to, and held by and for public investors.
- d. Title 1  
Sec. 101

(b) Duties of the Board

The Board shall, subject to action by the Commission under section 107, and once a determination is made by the Commission under subsection (d) of this section - -

- (1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;
- (2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;
- (3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;
- (4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms in accordance with section 105;
- (5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this act, in order to protect investors, or to further the public interest;
- (6) enforce compliance with the Act, the rules of the Board, professional standards and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and



- (7) set the budget and manage the operations of the Board and the staff of the Board
- e. Public accounting firms that prepare or issue, or participate in the preparation or issuance of, any audit report with respect to any issuer.
- f. Sec 104
  - (a) In General – The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.
- g. Sec 103
  - (a) (1) ...amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.
- h. Sec 106
  - (a) (1) In General  
Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any state, except...
- i. Recognition of Accounting Standards
  - (1) In General – In carrying out its authority under subsection (a) and under section 13(b) of the Securities Act of 1934, the Commission may recognize, as generally accepted for purposes of the securities laws, any accounting principles established by a standard setting body...
- j. Funding
  - 1. The “Board” – annual accounting support fee for the Board (among issuers)
  - 2. Financial Accounting Standards Board – Annual Accounting Support for Standard Setting Body (among issuers)

k. Title 11  
Sec 201

Non-audit service excluded

- (1) bookkeeping or other services related to the accounting records or financial statements of the audit client;
- (2) financial information systems design and implementation;
- (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (4) actuarial services;
- (5) internal audit outsourcing services;
- (6) management functions or human resources;
- (7) broker or dealer, investment adviser, or investment banking services;
- (8) legal services and expert services unrelated to the audit; and
- (9) any other service that the Board determines, by regulation, is impermissible.

Tax services for an audit client

Only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i)

l. Title IV  
Sec 404 Management Assessment of Internal Controls

- (a) ...each annual report... contain an internal control report, which shall –
- (1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
  - (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting

- m. Management does not like the responsibility relating to internal controls and management may not have very much expertise in this area.

### CASE 1-11 REGULATION OF SMALLER PUBLIC COMPANIES

- a. There is substantial cost to a company to comply with the SEC securities regulations. These costs could result in companies leaving the United States to avoid the SEC regulations.

Companies could also decide to go private, which would reduce the number of securities available to the public.

Companies could also decide to go out of business.

### CASE 1-12 STABLE FUNDING

(This case provides for a discussion of the importance of stable funding for standard setters.)

- a. The FASB is funded through the issuer accounting support fee since enactment of Sarbanes-Oxley.
- b. The Dodd-Frank Act recognized the importance of sufficient and stable resources by authorizing the commission to require a national securities association to fund the GASB by establishing directed FINRA to establish this fee which will strengthen the independence of GASB).

(Note: This fee has likely been established).

- c. IASB (IFRS) does not have stable funding mechanisms.

### CASE 1-13 RULES OR FEEL?

(This case provides the opportunity to compare the IFRSs more principles-based GAAP with the U.S. rules-based GAAP.)

- a. U.S. accounting standards consist of hundreds of pages of rules. The principles-based approach (a broad-brush approach) relies more on companies to reasonably apply the rules and using their professional judgment. Some maintain that principles-based approach would result in more lawsuits because of the subjectivity of professional judgment. Others maintain that a principles-based approach would result in fewer lawsuits.
- b. This is an opinion question. Several reasons for giving up U.S. GAAP should be given along with several reasons for not giving up U.S. GAAP.

## CASE 1-14 PCAOB ENFORCEMENT – IFRS STANDARDS

(This case is intended to serve as a forum for discussing enforcement under an IFRS environment.)

- a. It will be more difficult for the PCAOB to enforce standards under an IFRS environment.
- b. If the only attempt at enforcement is in the United States, then companies in the United States will be at a disadvantage in an IFRS environment.