

Chapter 1 course notes

[Business](#), [Company](#)



Financial Accounting Theory and Analysis 10e Chapter 1 - The Development of Accounting Theory What is Theory? Webster defines theory as “

Systematically organized knowledge, applicable in a relatively wide variety of circumstances; a system of assumptions, accepted principles and rules of procedure to analyze, predict or otherwise explain the nature of behavior of a specified set of phenomena. ” Why is the development of a general theory of accounting important?

The development of a general theory of accounting is because of the role accounting plays in our economic society. We live in a capitalistic society which is characterized by a self-regulated market that operates through the forces of supply and demand. What is the relationship of accounting research to accounting theory? The goal of accounting theory is to provide a set of principles and relationships that explains observed practices and predicts unobserved practices.

That is, accounting theory should be able to explain why companies elect certain accounting methods over others and should enable users to predict the attributes of firms that elect various accounting methods. And as in other disciplines, accounting theory should also be verifiable through accounting research. Accounting research is needed to attain a more general theory of accounting, and in this regard the various theories of accounting that have been posited must be subjected to verification. The Early History of Accounting

Zenon Papyri * Accounting records have been found to date back several thousand years in various parts of the world. Discovered in 1915, the Zenon Papyri contained information Apollonius private estate for a period of about

30 years concerning construction projects, agricultural activities, and business operations during the 3rd century B. C. According to Hain, this “surprisingly elaborate accounting system” was used in Greece since the fifth century B. C. “Zenon’s accounting system contained provisions for responsibility accounting, a written record of all transactions, a personal account for wages paid to employees, inventory records, and a record of asset acquisitions and disposals. In addition, there is evidence that all the accounts were audited.”

The Impact of the Renaissance * It wasn’t until approximately 1300-1500 the need arose for more accurate records due to the Italians merchants vigorously pursuing trade and commerce. Italian merchants borrowed Arabic numeral system and the basis of arithmetic and an evolving trend toward the present double entry book keeping system developed. In 1494 an Italian monk, Fra Luca Pacioli, wrote a book on arithmetic that included a description of double-entry bookkeeping. Pacioli’s work, *Summa de Arithmetica Geometria Proportioniet Proportionalita*, did not fully describe double-entry bookkeeping; rather, it formalized the practices and ideas that had been evolving over the years. Double-entry bookkeeping enabled business organizations to keep complete records of transactions and ultimately resulted in the ability to prepare financial statements. The evolution of joint ventures into ongoing businesses

As ongoing business organizations replaced isolated ventures, it became necessary to develop accounting records and reports that reflected a continuing investment of capital employed in various ways and to periodically summarize the results of activities. By the nineteenth century, bookkeeping expanded into accounting, and the concept that the owner’s

original contribution, plus or minus profits or losses, indicated net worth emerged. However, profit was considered an increase in assets from any source, as the concepts of cost and income were yet to be developed.

Another factor that influenced the development of accounting during the nineteenth century was the evolution in England of joint ventures into business corporations. Under the corporate form of business, owners (stockholders) may not be management. Thus many individuals, external to the business itself, needed information about the corporation's activities. Moreover, owners and prospective owners wanted to evaluate whether stockholder investments have yielded a return.

As a consequence, the emerging existence of corporations created a need for periodic reporting as well as a need to distinguish between capital and income. The impact of the industrial revolution and the progressive movement The industrial revolution and the succession of the Companies Acts in England also increased the need for professional standards and accountants. In the later part of the nineteenth century, the industrial revolution arrived in the United States, bringing the need for more formal accounting procedures and standards. Railroads became a major economic influence.

These companies created the need for supporting industries, which in turn led to increases in the market for corporate securities and an increased need for trained accountants as the separation of the management and ownership functions became more distinct. The concept of capital maintenance The major concern of accounting during the early 1900s was the development of a theory that could cope with corporate abuses that were occurring at that

time, and capital maintenance emerged as a concept. This concept evolved from maintaining invested capital intact to maintaining the physical productive capacity of the firm to maintaining real capital.

In essence, this last view of capital maintenance was an extension of the economic concept of income (see Chapter 5) that there could be no increase in wealth unless the stockholder or the firm were better off at the end of the period than at the beginning. The accountant as a protector of business interests World War I changed the public's attitude toward the business sector. Many people believed that the successful completion of the war could at least partially be attributed to the ingenuity of American business. As a consequence, the public perceived that business had reformed and that external regulation was no longer necessary.

The accountant's role changed from protector of third parties to protector of business interests. Critics of accounting practice during the 1920s suggested that accountants abdicated the stewardship role, placed too much emphasis on the needs of management, and permitted too much flexibility in financial reporting. During this time financial statements were viewed as the representations of management, and accountants did not have the ability to require businesses to use accounting principles they did not wish to employ. The result of this attitude is well known. In 1929 the stock market crashed and the Great Depression ensued.

Although accountants were not initially blamed for these events, the possibility of governmental intervention in the corporate sector loomed. Accounting in the United States since 1930 Meetings between NYSE and AIA One of the first attempts to improve accounting began shortly after the

inception of the Great Depression with a series of meetings between representatives of the New York Stock Exchange (NYSE) and the American Institute of Accountants. The purpose of these meetings was to discuss problems pertaining to the interests of investors, the NYSE, and accountants in the preparation of external financial statements.

The cooperative efforts between the members of the NYSE and the AIA were well received. However, the post-Depression atmosphere in the United States was characterized by regulation. There was even legislation introduced that would have required auditors to be licensed by the federal government after passing a civil service examination. AAA Similarly, in 1935 the American Association of University Instructors in Accounting changed its name to the American Accounting Association (AAA) and announced its intention to expand its activities in the research and development of accounting principles and standards.

The first result of these expanded activities was the publication, in 1936, of a brief report cautiously titled “ A Tentative Statement of Accounting Principles Underlying Corporate Financial Statements. ” The four-and-one-half-page document summarized the significant concepts underlying financial statements at that time. SEC (Securities And Exchange Commission) Two of the most important pieces of legislation passed at this time were the Securities Act of 1933 and the Securities Exchange Act of 1934, which established the Securities and Exchange Commission (SEC).

The SEC was created to administer various securities acts. Under powers provided by Congress, the SEC was given the authority to prescribe accounting principles and reporting practices. Nevertheless, because the SEC

has acted as an overseer and allowed the private sector to develop accounting principles, this authority has seldom been used. However, the SEC has exerted pressure on the accounting profession and has been especially interested in narrowing areas of difference in accounting practice.

* Securities Act of 1933

A federal piece of legislation enacted as a result of the market crash of 1929. The legislation had two main goals: (1) to ensure more transparency in financial statements so investors can make informed decisions about investments, and (2) to establish laws against misrepresentation and fraudulent activities in the securities markets. * Securities Exchange Act of 1934 The Securities Exchange Act of 1934 was created to provide governance of securities transactions on the secondary market (after issue) and regulate the exchanges and broker-dealers in order to protect the investing public.

Committee on Accounting Procedure The AICPA's Committee on Accounting Procedure (CAP) was formed in 1936. The committee had authority to issue pronouncements on matters of accounting practice and procedure in order to establish generally accepted practices. CAP was relatively inactive during its first two years, but became more active in response to the SEC's release of ASR No. 4. One of the first responses was to expand CAP membership from 7 to 21. Major concerns were: * Use of the historical cost model of accounting.

The then-accepted definition of assets as unamortized cost was seen by some critics as allowing management too much flexibility in deciding when to charge costs to expense. * The impact on inflation on reported profits. Lobbies were held by several companies in the 1940s for the use of

replacement cost depreciation. Both CAP and the SEC rejected the efforts. This decade long debate didn't until Congress passed legislation in 1954 amending the IRS Tax Code to allow accelerated depreciation. CAP works were originally published in the form of Accounting Research Bulletins (ARBs).

The pronouncements did not dictate mandatory practice and received authority only from their general acceptance. The Accounting Research Bulletins were consolidated in 1953 into Accounting Terminology Bulletin No. 1, "Review and Resume" and ARB No 43 through 51 was published from 1953 until 1959. The recommendations of these bulletins that have not been superseded are contained in the FASB Accounting Standards Codifications. Accounting Principles Board By 1959 the methods of formulating accounting principles were being questioned as not arising from research or based on theory.

The CAP was also criticized for acting in a piecemeal fashion and issuing standards that, in many cases, were inconsistent. Additionally, all of its members were part-time and as a result their independence was questioned. Finally, the fact that all of the CAP members were required to be AICPA members prevented many financial executives, investors, and academics from serving on the committee. As a result, accountants and financial statement users were calling for wider representation in the development of accounting principles.

The AICPA responded to the alleged shortcomings of the CAP by forming the Accounting Principles Board (APB). The objectives of this body were to advance the written expression of generally accepted accounting principles

(GAAP), to narrow areas of difference in appropriate practice, and to in the method of establishing accounting principles was quickly squelched when the first APB chairman, Weldon Powell, voiced his belief that accounting research was more applied and pure and that the usefulness of the end product was a major concern.

The APB was composed of from seventeen to twenty-one members, who were selected primarily from the accounting profession but also included individuals from industry, government, and academia. Initially, the pronouncements of the APB, termed “opinions,” were not mandatory practice; however, the issuance of APB Opinion No. 2 (see FASB ASC 740-10-25 and 45) and a subsequent partial retraction contained in APB Opinion No. 4 (see FASB ASC 740-10-50) highlighted the need for standard-setting groups to have more authority. Financial Accounting Standards Board

Due to the growing criticism of the APB, in 1971 the board of directors of the AICPA appointed two committees. The Wheat Committee, chaired by Francis Wheat, was to study how financial accounting principles should be established. The Trueblood Committee, chaired by Robert Trueblood, was asked to determine the objectives of financial statements. The Wheat Committee issued its report in 1972 recommending that the APB be abolished and the Financial Accounting Standards Board (FASB) be created. In contrast to the APB, whose members were all from the AICPA, this new board was to comprise representatives from various organizations.

The members of the FASB were also to be full-time paid employees, unlike the APB members, who served part-time and were not paid. the Accounting Principles Board Formation and structure The APB was composed of from

seventeen to twenty-one members, who were selected primarily from the accounting profession but also included individuals from industry, government, and academia. Types of pronouncements * APB Opinions Initially, the pronouncements of the APB, termed “ opinions,” were not mandatory practice; however, the issuance of APB Opinion No. 2 (see FASB ASC 740-10-25 and 45) and a subsequent partial retraction contained in APB Opinion No. (see FASB ASC 740-10-50) highlighted the need for standard-setting groups to have more authority. The flap over accounting for the investment tax Credit This controversy was over the proper method to use in accounting for the investment tax credit. In the early 1960s the country was suffering from the effects of a recession. After President John F. Kennedy took office, his advisors suggested an innovative fiscal economic policy that involved a direct income tax credit (as opposed to a tax deduction) based on a percentage of the cost of a qualified investment.

Congress passed legislation creating the investment tax credit in 1961. The APB was then faced with deciding how companies should record and report the effects of the investment tax credit. It considered two alternative approaches: 1. The flow-through method, which treated the tax credit as a decrease in income tax expense in the year it occurred. 2. The deferred method, which treated the tax credit as a reduction in the cost of the asset and therefore was reflected over the life of the asset through Rule 203

The lack of support for some of the APB’s pronouncements and concern over the formulation and acceptance of GAAP caused the Council of the AICPA to adopt Rule 203 of the Code of Professional Ethics. 10 This rule requires departures from accounting principles published in APB Opinions or

Accounting Research Bulletins (or subsequently FASB Statements and now the FASB ASC) to be disclosed in footnotes to financial statements or in independent auditors' reports when the effects of such departures are material.

This action has had the effect of requiring companies and public accountants who deviate from authoritative pronouncements to justify such departures. Criticism of the APB

1. The independence of the members of the APB. The individuals serving on the board had full-time responsibilities elsewhere that might influence their views of certain issues.
2. The structure of the board. The largest eight public accounting firms (at that time) were automatically awarded one member, and there were usually five or six other public accountants on the APB.
3. Response time.

The emerging accounting problems were not being investigated and solved quickly enough by the part-time members. The financial Accounting Standards Board (FASB)

The Wheat Committee The Wheat Committee, chaired by Francis Wheat, was to study how financial accounting principles should be established. The AICPA quickly adopted the Wheat Committee recommendations, and the FASB became the official body charged with issuing accounting standards.

The Trueblood Committee The Trueblood Committee, chaired by Robert Trueblood, was asked to determine the objectives of financial statements.

The FASB was established The Wheat Committee issued its report in 1972 recommending that the APB be abolished and the Financial Accounting Standards Board (FASB) be created. The structure of the FASB

The structure of the FASB is as follows. A board of trustees nominated by organizations

whose members have special knowledge and interest in financial reporting is selected. The organizations originally chosen to select the trustees were the American Accounting Association; the AICPA; the Financial Executives Institute; the National Association of Accountants (The NAA's name was later changed to Institute of Management Accountants in 1991), and the Financial Analysts Federation. In 1997 the board of trustees added four members from public interest organizations. The board that governs the FASB is the Financial Accounting Foundation (FAF). The FAF appoints the Financial Accounting Standards Advisory Council (FASAC), which advises the FASB on major policy issues, the selection of task forces, and the agenda of topics. The number of members on the FASAC varies from year to year. The bylaws call for at least twenty members to be appointed.

However, the actual number of members has grown to about thirty in recent years to obtain representation from a wider group of interested parties. FASB Mission The FASB's mission is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. In attempting to accomplish this mission, the FASB seeks to: 1. Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency 2.

Keep standards current to reflect changes in methods of doing business and changes in the economic environment 3. Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process 4. Promote the international comparability of accounting standards concurrent with improving the quality of financial

reporting 5. Improve the common understanding of the nature and purposes of information contained in financial reports

Type of Pronouncements *

Statements of Financial Accounting Concepts

Statements of Financial Accounting Standards *

Interpretations *

Technical Bullentins

Originally, the FASB issued two types of pronouncements, Statements of Financial Accounting Standards (SFASs) and Interpretations. Subsequently, the FASB established two new series of releases: (1) Statements of Financial Accounting Concepts (SFACs) and (2) Technical Bulletins. SFASs conveyed required accounting methods and procedures for specific accounting issues and officially created GAAP. Interpretations were modifications or extensions of issues pronouncements.

SFACs are intended to establish the objectives and concepts that the FASB will use in developing standards of financial accounting and reporting. To date, the FASB has issued seven SFACs, which are discussed in depth in Chapters 2, 6, and 7. SFACs differed from Statements of Financial Accounting Standards in that they did not establish GAAP. Similarly, they are not intended to invoke Rule 203 of the Rules of Conduct of the Code of Professional Ethics. It is anticipated that the major beneficiary of these SFACs will be the FASB itself.

However, knowledge of the objectives and concepts the board uses should enable financial statement users to better understand the content and limitations of financial accounting information. Technical Bulletins were strictly interpretive in nature and did not establish new standards or amend existing standards. They were intended to provide guidance on financial accounting and reporting problems on a timely basis.

Emerging Issues One

of the first criticisms of the FASB was for failing to provide timely guidance on emerging implementation and practice problems.

During 1984 the FASB responded to this criticism by (1) establishing a task force, the Emerging Issues Task Force (EITF), to assist in identifying issues and problems that might require action; and (2) expanding the scope of the FASB Technical Bulletins in an effort to offer quicker guidance on a wider variety of issues. The EITF was formed in response to two conflicting issues. On the one hand, accountants are faced with a variety of issues that are not fully addressed in accounting pronouncements, such as interest rate swaps or new financial instruments. These and other new issues need immediate resolution.

On the other hand, many accountants maintain that the ever-increasing body of professional pronouncements has created a standards overload problem (discussed in more detail below). The FASB established the EITF in an attempt to simultaneously address both issues. The goal of the EITF is to provide timely guidance on new issues while limiting the number of issues whose resolutions require formal pronouncements by the FASB.

Standards Overload One of the first criticisms of the FASB was for failing to provide timely guidance on emerging implementation and practice problems.

During 1984 the FASB responded to this criticism by (1) establishing a task force, the Emerging Issues Task Force (EITF), to assist in identifying issues and problems that might require action; and (2) expanding the scope of the FASB Technical Bulletins in an effort to offer quicker guidance on a wider variety of issues. The EITF was formed in response to two conflicting issues. On the one hand, accountants are faced with a variety of issues that are not

fully addressed in accounting pronouncements, such as interest rate swaps or new financial instruments.

These and other new issues need immediate resolution. On the other hand, many accountants maintain that the ever-increasing body of professional pronouncements has created a standards overload problem (discussed in more detail below). The FASB established the EITF in an attempt to simultaneously address both issues. The goal of the EITF is to provide timely guidance on new issues while limiting the number of issues whose resolutions require formal pronouncements by the FASB. Standard setting as a political process

A highly influential academic accountant stated that accounting standards are as much a product of political action as they are of careful logic or empirical findings.¹⁵ This phenomenon exists because a variety of parties are interested in and affected by the development of accounting standards. Various users of accounting information have found that the best way to influence the formulation of accounting standards is to attempt to influence the standard setters. The CAP, APB, and FASB have all come under a great deal of pressure to develop or amend standards so as to benefit a particular user group.

For example, the APB had originally intended to develop a comprehensive theory of accounting before attempting to solve any current problems; however, this approach was abandoned when it was determined that such an effort might take up to five years and that the SEC would not wait that long before taking action. The Business Roundtable engaged in what initially was a successful effort (later reversed) to increase the required consensus for

passage of a SFAS from a simple majority to five of the seven members of the FASB.

Congressional action was threatened over the FASB's proposed elimination of the pooling of interest method of accounting for business combinations (see Chapter 16). Two of the most notable examples of the politicizing of accounting standards involved the issues of employee stock options and fair value accounting. Economic Consequences The increased pressure on the standard-setting process is not surprising, considering that many accounting standards have significant economic consequences. Economic consequences refers to the impact of accounting reports on various segments of our economic society.

This concept holds that the accounting practices a company adopts affect its security price and value. Consequently, the choice of accounting methods influences decision making rather than just reflecting the results of these decisions. Consider the release of the FASB's pronouncement on other postretirement benefits (OPRBs) FASB Statement No. 106, "Other Post Retirement Benefits" (see FASB ASC 715-10-30, 60, and 80). The accounting guidelines for OPRBs required companies to change from a pay-as-you-go basis to an accrual basis for healthcare and other benefits that companies provide to retirees and their dependents.

The accrual basis requires companies to measure the obligation to provide future services and accrue these costs during the years employees provide service. This change in accounting caused a large increase in recorded expenses for many companies. Consequently, a number of companies simply ceased providing such benefits to their employees, at a large social cost.

The impact on our economic society of accounting for OPRBs illustrates the need for the FASB to fully consider both the necessity to further develop sound reporting practices and the possible economic consequences of new codification content.

Accounting standard setting does not exist in a vacuum. It cannot be completely insulated from political pressures, nor can it avoid carefully evaluating the possible ramifications of standard setting. *gaap* Evolution of phrase: * Changed wording of auditor's certificate brought about by meetings between NYSE and AIA One result of the meetings between the AICPA and members of the NYSE following the onset of the Great Depression was a revision in the wording of the certificate issued by CPAs. The opinion paragraph formerly stated that the financial statements had been examined and were accurate.

The terminology was changed to say that the statements are "fairly presented in accordance with generally accepted accounting principles." This expression is now interpreted as encompassing the conventions, rules, and procedures that are necessary to explain accepted accounting practice at a given time. Therefore financial statements are fair only to the extent that the principles are fair and the statements comply with the principles. * The APB's definition * The Auditing Standards Executive Committee's definition The current sources of GAAP consist of four levels described as A, B, C, and D by Statement of Auditing Standards No 69 the business reporting research project Steering Committee Working Group the role of ethics in accounting Ethics are concerned with the types of behavior society considers right and wrong. Accounting ethics incorporate social standards of behavior

as well as behavioral standards that relate specifically to the profession. The environment of public accounting has become ethically complex. The accountants' Code of Professional Ethics developed by the AICPA has evolved over time, and as business transactions have become more and more complex, ethical issues have also become more complex.

Accounting in Crisis – the events of the early 2000s On January 1, 2001, Enron's stock was selling for over \$90 per share. From that time until the early summer of 2001, nineteen investment research firms reviewed its performance and twelve had given it a "strong buy" recommendation, while five others had recommended it as "buy." ²⁷ Additionally, the company's 2000 annual report indicated that its auditor had not found any significant accounting problems. However, on August 14, 2001, it was announced that the company's president, Jeffery Skilling, had resigned after only six months on the job for "purely personal reasons. Enron used what were termed special-purpose entities (SPEs) now termed variable interest entities (VIEs) to access capital and hedge risk. ²⁸ By using SPEs such as limited partnerships with outside parties, a company may be permitted to increase its financial leverage and return on assets without reporting debt on its balance sheet. ²⁹ The arrangement works as follows: An entity contributes fixed assets and related debt to an SPE in exchange for an ownership interest.

The SPE then borrows large sums of money from a financial institution to purchase assets or conduct other business without the debt or assets showing up on the originating company's financial statements. The originating company can also sell leveraged assets to the SPE and record a profit. At the time these transactions took place, the FASB required that only

3 percent of a SPE be owned by an outside investor. If this guideline is met, the SPE didn't need to be consolidated and the SPE's debt was not disclosed on the originating company's financial statements.

Enron used SPEs to new degrees of complexity and sophistication, capitalizing them with not only a variety of fixed assets and liabilities but also extremely complex derivative financial instruments, its own restricted stock, rights to acquire its stock, and related liabilities. Additionally, as Enron's financial dealings became more complicated, the company apparently also transferred troubled assets that were falling in value, such as certain overseas energy facilities, its broadband operation, or stock in companies that had been spun off to the SPEs. As a consequence, the losses on these assets were kept off Enron's books.

To compensate partnership investors for assuming downside risk, Enron promised to issue additional shares of its stock. As the value of the assets in these partnerships fell, Enron began to incur larger and larger obligations to issue its own stock farther down the road. The problem was later compounded as the value of Enron's stock declined. On October 16, 2001, the company reported a third-quarter loss and its stock dropped to about \$33 a share. On October 28, as some of the problems with the SPEs were made public, a special committee of the board of directors of Enron was established under the chairmanship of William C.

Powers, dean of the University of Texas Law School. The Powers Committee Report concluded that some Enron employees were directly involved in the SPEs and were enriched by tens of millions of dollars they never should have received. The committee also found that many of the transactions were

designed to achieve favorable financial statement results and were not based on legitimate economic objectives or to transfer risk. International Accounting standards A truly global economy emerged during the 1990s, as many U. S. companies generated significant amounts of revenue and profits in foreign markets.

Multinational companies are faced with decisions on the allocation of resources to their most efficient uses. These allocations cannot be accomplished without accurate and reliable financial information. Companies seeking capital or investment opportunities across national boundaries face cost and time issues. Capitalseeking firms must reconcile their financial statements to the accounting rules of the nation in which they are seeking capital, and investors must identify foreign reporting differences. The increasingly global economy requires that this process be simplified.

Thus there is a push to harmonize international accounting standards. The IASB is an independent private sector body that was formed in 1973 to achieve this purpose. Its objectives are 1. To formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance 2. To work generally for the improvement and harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements³³

These objectives have resulted in attempts to coordinate and harmonize the activities of the many countries and agencies engaged in setting accounting standards. The IASB standards also provide a useful starting point for developing countries wishing to establish accounting standards. ³⁴ The IASB

has also developed a conceptual framework titled the Framework for the Preparation and Presentation of Financial Statements. 35 The conclusions articulated in this release are similar to those contained in the FASB's Conceptual Framework Project.

That is, the objective of financial statements is to provide useful information to a wide range of users for decision-making purposes. The information provided should contain the qualitative characteristics of relevance, reliability, comparability, and understandability. At the time this book was published, the IASB had issued forty-one Statements of Accounting Standards (IASs) and ten Statements of Financial Reporting Standards (IFRSs). However, since it has no enforcement authority, the IASB must rely on the “best endeavors” of its members.

Neither the FASB nor the SEC is a member of the IASB, so its standards have no authority in the United States at the present time. However, the SEC recently ruled that foreign companies that adopt IASB standards are eligible to list their securities for sale on U. S. stock exchanges (see Chapter 3 for a further discussion of this issue). As noted in Chapters 2 and 3, there is also a movement to have IASB standards become GAAP for U. S. companies. The emergence of multinational corporations has resulted in a need for the increased harmonization of worldwide accounting standards.

The role of the IASB is discussed in more detail in Chapter 3, and the IASB standards are reviewed throughout this text in chapters dealing with the issues addressed by each IAS or IFRS. Cases • Case 1-1 Sources of GAAP The FASB ASC is now the sole authoritative source for all U. S. GAAP. a. What are the major goals of the FASB ASC? b. How is the FASB ASC expected to

improve the practice of accounting? c. What literature is now contained in the FASB ASC? d. What should an accountant do if the guidance for a particular transaction or event is not specified within the FASB ASC? • Case 1-2 Accounting Ethics

When the FASB issues new standards, the implementation date is frequently 12 months from date of issuance, and early implementation is encouraged. Becky Hoger, controller, discusses with her financial vice president the need for early implementation of a standard that would result in a fairer presentation of the company's financial condition and earnings. When the financial vice president determines that early implementation of the standard will adversely affect the reported net income for the year, he discourages Hoger from implementing the standard until it is required. Required: a. What, if any, ethical issue is involved in this case? . Is the financial vice president acting improperly or immorally? c. What does Hoger have to gain by advocacy of early implementation? d. Who might be affected by the decision against early implementation? (CMA adapted) • Case 1-3 Politicalization of Accounting Standards Some accountants have said that politicalization in the development and acceptance of generally accepted accounting principles (i. e. , standard setting) is taking place. Some use the term politicalization in a narrow sense to mean the influence by governmental agencies, particularly the SEC, on the development of generally accepted accounting principles.

Others use it more broadly to mean the compromising that takes place in bodies responsible for developing these principles because of the influence and pressure of interested groups (SEC, American Accounting Association, businesses through their various organizations, Institute of Management

Accountants, financial analysts, bankers, lawyers, etc.). Required: a. The Committee on Accounting Procedure of the AICPA was established in the mid- to late 1930s and functioned until 1959, at which time the Accounting Principles Board came into existence.

In 1973, the Financial Accounting Standards Board was formed, and the APB went out of existence. Do the reasons these groups were formed, their methods of operation while in existence, and the reasons for the demise of the first two indicate an increasing politicalization (as the term is used in the broad sense) of accounting standard setting? Explain your answer by indicating how the CAP, APB, and FASB operated or operate. Cite specific developments that tend to support your answer. b. What arguments can be raised to support the politicalization of accounting standard setting? . What arguments can be raised against the politicalization of accounting standard setting? (CMA adapted) • Case 1-4 Generally Accepted Accounting Principles

At the completion of the Darby Department Store audit, the president asks about the meaning of the phrase “ in conformity with generally accepted accounting principles,” which appears in your audit report on the management’s financial statements. He observes that the meaning of the phrase must include more than what he thinks of as “ principles. ” Required: a.

Explain the meaning of the term accounting principles as used in the audit report. (Do not in this part discuss the significance of “ generally accepted. ”) b. The president wants to know how you determine whether or not an accounting principle is generally accepted. Discuss the sources of evidence for determining whether an accounting principle has substantial authoritative

support. c. The president believes that diversity in accounting practice will always exist among independent entities despite continual improvements in comparability.

Discuss the arguments that support his belief. • Case 1-5 The Evolution of the Accounting Profession The nineteenth century witnessed the evolution of joint ventures into business corporations. Required: Discuss how the emergence and growth of the corporate form of business affected perceptions regarding the role of the accounting profession in financial reporting in England and the United States. • Case 1-6 Accounting in Crisis During the early 2000s, the role of accounting and the auditing profession changed and several accounting scandals were uncovered. Required: a.

What conditions caused accounting and the auditing profession role to change during this time? b. What major changes occurred as a result of the accounting scandals at that time? • Case 1-7 The FASB The FASB is the official body charged with issuing accounting standards. Required: a. Discuss the structure of the FASB. b. How are the Financial Accounting Foundation members nominated? c. SFAC No. 2 describes a number of key characteristics or qualities for accounting information. Briefly discuss the importance of any three of these qualities for financial reporting purposes. CMA adapted) FASB ASC Research For each of the following research cases, search the FASB ASC database for information to address the issues. Cut and paste the FASB ASC paragraphs that support your responses. Then summarize briefly what your responses are, citing the paragraphs used to support your responses. • FASB ASC 1-1 Variable Interest Entities In this chapter, we discuss how Enron and other companies use Variable Interest

Entities (VIEs) to keep the effects of transactions and events off corporate balance sheets. 1. How does the FASB define a VIE?

In other words, how does an entity qualify to be a VIE? 2. Is a company that meets the definition of a VIE required to consolidate the VIE? • FASB ASC 1-2 Status of Accounting Research Bulletins Portions of ARB No. 43 are still considered GAAP. Three of the most important issues covered in ARB No. 43 are revenue recognition, treasury stock, and comparative financial statements. Find the appropriate sections of the FASB ASC, originally contained in ARB No. 43, that address these issues. Cite the sources and copy the relevant information. • FASB ASC 1-3 Accounting for the Investment Tax Credit

The accounting alternative treatments for the investment tax credit originally outlined in APB Opinions 2 and 4 are still considered GAAP. Find and cite the FASB ASC paragraphs and copy the relevant information. • FASB ASC 1-4 Securities and Exchange Commission Comments SEC observers frequently provide comments at EITF meetings. Find, cite, and copy the observer comments on: 1. Revenue recognition—customer payments and incentives 2. Debt with conversions and other options 3. Software cost of sales and services • FASB ASC 1-5 Generally Accepted Accounting Procedure Guidelines

Find the guidelines for determining GAAP in the FASB ASC. Room for Debate • Debate 1-1 Which Body Should Set Accounting Standards in the United States? Team Debate Team 1: Argue that the SEC should set accounting standards in the United States. Team 2: Argue that the FASB should set accounting standards in the United States. • Debate 1-2 Should the Scope of

Accounting Standards Be Narrowed Further? Team Debate Team 1: Pretend you are management. Argue against the narrowing of accounting choices. Team 2: Pretend you are a prospective investor. Argue for the narrowing of accounting choices.