# Intermediate Accounting I

## Exam 1 Review

* **What is the objective of accounting?**
  + To provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.
* **What is accounting’s role in the capital allocation process?**
  + Involves buying, selling, or holding equity and debt instruments, and providing or settling loans and other forms of credit.
  + If a company’s financial performance is measured accurately, fairly, and on a timely basis, the right managers and companies are able to attract investment capital. To provide unreliable and irrelevant information leads to poor capital allocation which adversely affects the securities market.
* **How do major parties involved (SEC, FASB) do in the process of establishing GAAP in the U.S.?** 
  + GAAP consists of accounting practices, procedures, theories, concepts, and methods which are recognized by a large majority of practicing accountants as well as other members of the business and financial community. Rules based.
  + **SEC** – Encourages private standard-setting body, requires public companies to adhere to GAAP and provides oversight and enforcement authority.
  + **FASB – Financial Accounting Standards Board –** Mission is to establish and improve standards of financial accounting and reporting.
* **How is GAAP enforced?**
  + Must file periodic reports with the SEC. They must be prepared in accordance with GAAP and audited. The SEC has enforcement power and can send deficiency notices to firms that are not reporting information appropriately according to GAAP or SEC rules.
  + Audit firms face legal liability if it is later shown that the statements were materially misstated and the audit firm did not carry out its professional responsibilities.
* **Convergence of U.S. and International GAAP.** 
  + The EU allows you to list securities in European markets using GAAP instead of IFRS.
  + They want a single set of high quality global accounting standards that would benefit U.S. investors.
* **What does IFRS mean?** 
  + International Financial Reporting Standards, issued by IASB. Principle-based.
* **Who is the IASB?**
  + International Accounting Standards Board
* SEC
  + Who is the SEC?
  + **What are the following reports?**
    - 10-K – Annual Report
    - 10-Q – Quarterly Report
    - 8-K – Current Report
  + What are major triggering events that companies must disclose in a form 8-K to the SEC?
    - Adoption, amendment, or termination of any material definite agreement not in the ordinary course of business; change in auditors; changes in control of the registrant; acquisition or disposition of significant amount of assets other than the ordinary course of business; plants to exit a business/terminate employees; creation of a direct financial obligation or obligation under an off-balance sheet arrangement; and any triggering event that accelerates or increases such obligations; change in a rating agency decision; issuance of a credit watch; change in company outlook; determination that assets are impaired; bankruptcy or receivership of registrant; change of fiscal year of the registrant; appointment or resignation of directors and principle officers and registrant.
* **Sarbanes-Oxley Act**
  + **General awareness of the key features of the legislation**
    - Established PCAOB to regulate audit profession.
    - Established new requirements for CEO’s and CFO’s to certify accuracy and completeness of their financial statements. False statements punishable by fines and imprisonment.
  + **Who is the PCAOB?**
    - Public Company Accountability Oversight Board
    - Establishes a five-member oversight board with investigative and disciplinary powers over auditors of publicly held companies; board is majority independent (two of the 5 members may be CPAs); funded by publicly held companies, must adopt or establish auditing standards and is overseen by SEC.
    - Board must perform annual inspections of accounting firms that audit 100 or more public companies and at least tri-annual inspections of other public company auditors.
  + What is management’s responsibility for financial reporting and internal controls?
* **Qualitative Characteristics**
  + **Fundamental Qualities: Relevance – Information is capable of making a difference in a decision**
    - **Predictive Value** - Information that can help users form expectations about future performance.
    - **Confirmatory Value** - The information validates or refutes expectations based on previous evaluations.
    - **Materiality** – The information is material if omitting it or misstating it could influence decisions that users make on the basis of the reported financial information.
  + **Fundamental Qualities: Faithful Representation – Numbers and descriptions match what really happened or existed**
    - **Completeness** – All necessary info (including descriptions and explanations) is provided for understandability
    - **Neutrality** – A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasized, deemphasized, or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users
    - **Free from error** – Does not mean accurate in all respects. Free from error means that there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process.
  + **Enhancing Qualities – Characteristics that enhance the usefulness of information that is relevant and faithfully represented**
    - **Comparability –** Consistently refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal
    - **Verifiability –** Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation
    - **Timeliness –** Information is available before it loses its relevance.
    - **Understandability –** Reasonably informed users should be able to comprehend information that is clearly classified and presented.
  + **Third Level: Assumptions**
    - **Economic Entity –** The company records and reports its economic activities separately from that of its owners and other businesses
    - **Going Concern –** The company is assumed to last long enough to fulfill objectives and commitments.
    - **Monetary Unit –** Money is the common denominator of economic activity. The monetary unit is assumed to remain relatively stable over time in terms of purchasing power.
    - **Periodicity –** The company can divide its economic activities into artificial time periods for financial reporting.

Chapter 4 – Income Statement

1. Review Outline sections relating to topics covered in class.

2. *Definition/criteria for Extraordinary item, Discontinued operation*; recognize list of items that are specifically NOT extraordinary (Ch. 4 outline); know that IFRS does not permit Extraordinary Item classification. See Ch. 4 Review Problem-Q29.

3. Earnings Management—know definition (see Chapter 4 outline p. 9 discussion, homework question 6 in Chapter 4, and notes from Chapter 1-2 lectures including class example problems on materiality in Chapter 2.)

*4. Earnings Quality: If covered in class on Wed. Feb. 20, also know meaning of Quality of Earnings – Read textbook discussion, read outline information-p. 9; study homework questions 7 and 9 in Chapter 4.*

🡪 Even if we do cover Comprehensive Income and/or Accounting Changes and Error Correction in class on Wed. Feb. 20, these topics will not be tested on Exam 1.

Chapter 5 – Balance Sheet

1. Review Outline for discussion of items and where to include in the Balance Sheet.

2 Know terminology: shares authorized, issued, unissued, outstanding, and treasury stock—and how to compute when given sufficient information.

*🡪The following Chapter 5 topics will NOT be covered on Exam 1:*

* *Key differences under IFRS*
* *Techniques of Disclosure*
* *Balance Sheet Ratios*

Chapter 5 – Statement of Cash Flows

1. What is purpose/usefulness of SCF? (See outline/narrative in packet.)

2. Know/recognize the types of transactions that are reported in Operating, Investing, and Financing section of SCF. Know the 2 amounts that must be reported as footnotes to the indirect SCF. (Review outline/narrative; Illustration 5-18 in packet and in text; Homework E5-13) (You will need to know this info so that you can correctly prepare your worksheet or formal SCF.)

3. Calculate Free Cash Flow and know what it measures (See outline/narrative page 5); You will not be tested on the other two ratios in the outline/narrative. *See Homework E5-16 (b), E5-18 (b); Review Problem BE5-16*