

## Discussion Questions

1. *Matti, who has just completed his first finance course, is unsure whether he should take a course in business analysis and valuation using financial statements since he believes that financial analysis adds little value given the efficiency of capital markets. Explain to Matti when financial analysis can add value, even if capital markets are efficient.*
2. *A finance student states: "I don't understand why anyone pays any attention to accounting earnings numbers, given that a 'clean' number like cash from operations is readily available." Do you agree? Why or why not?*
3. *Bill Simon says, "We should get rid of the IASB, IFRS, and E.U. Accounting and Audit Directives, since free market forces will make sure that companies report reliable information." Do you agree? Why or why not?*
4. *Juan Perez argues that "learning how to do business analysis and valuation using financial statements is not very useful, unless you are interested in becoming a financial analyst." Comment.*

## Multiple Choice Questions

Q1.1. Lemons problems arise in capital markets when

- A. Managers are better informed about the value of their business ideas than investors
- B. Managers have an incentive to understate the value of their business ideas
- C. Managers and investors have conflicting interests
- D. A, B, and C
- E. A and C

Q1.2. Consider the following statement: "In countries with a model of strong legal protection of investors' rights, information intermediaries play a bigger role in preventing lemons problems than in countries with a model of weak legal protection of investors' rights." This statement is

- A. True
- B. False

Q1.3. Mandatory publication of audited financial statements is an imperfect solution to incentive and information problems between managers and investors because

- A. Accounting profits are typically less informative about firms' economic performance than cash flows
- B. The accounting standards governing the preparation of such financial statements are typically too loosely defined
- C. Managers unintentionally as well as strategically introduce noise into reported accounting performance through their accounting decisions
- D. None of the above

Q1.4. Which of the following items is not a required component of European public firms' financial statements?

- A. A statement of other comprehensive income
- B. An income statement
- C. A cash flow statement
- D. A statement of changes in equity
- E. All of the above items are required components

Q1.5. Consider the following statement: "An economic resource whose future benefits cannot be measured with a reasonable degree of certainty is not considered to be an asset for accounting purposes." This statement is

- A. True
- B. False

Q1.6. Which of the following statements is correct?

- A. Revenues cannot be recognized before cash is collected.
- B. Expenses cannot be recognized before the cash outflow has occurred.
- C. Revenues cannot be recognized if cash collection is uncertain.
- D. Expenses will always be recognized before or when the cash outflow occurs.
- E. None of the above.

Q1.7. Consider the following statement: "The extent to which financial statements accurately reflect the consequences of managers' operating, investment and financing decisions is a function of characteristics of the accounting environment and managers' accounting strategy." This statement is

- A. True
- B. False

Q1.8. Consider the following statement: "Accounting conventions and regulations that leave management no accounting discretion lead to more useful financial statements than accounting conventions and regulations that do grant accounting discretion." This statement is

- A. True
- B. False

Q1.9. Consider the following statement: "Financial reports of publicly listed firms are prepared using accrual accounting rather than cash accounting." This statement is

- A. True
- B. False

Q1.10. Which of the following statements is true?

- A. The implementation of the Revised Statutory Audit Directive and Regulation in the European Union has removed all systematic differences in the effectiveness of external auditing across countries.
- B. One of the objectives of the Revised Statutory Audit Directive and Regulation in the European Union is to set minimum standards for public audits that improve auditor independence.
- C. All audits of public firms within the European Union must be carried out in accordance with the set of Generally Accepted Auditing Standards, as promulgated by the Public Company Accounting Oversight Board.
- D. None of the above

Q1.11. Which of the following statements is true?

- A. Managerial legal liability regimes are equally strict across the member states of the European Union.
- B. Under a strict legal liability regime, managers tend to provide more forward-looking disclosures than under a loose regime.
- C. Managerial legal liability regimes are less strict in Germany than in the US.
- D. None of the above

Q1.12. One of the primary tasks of the European Securities and Markets Authority is to

- A. Improve the consistency of public enforcement activities across European countries.
- B. Publicly disclose all European public enforcement decisions.
- C. Develop a set of International Public Enforcement Standards.
- D. Discipline European public companies for violations of International Financial Reporting Standards.

Q1.13. Consider the following statement: "The outcomes of business strategy analysis affect the financial and prospective analyses but have no relevance for the accounting analysis." This statement is

- A. True
- B. False

Q1.14. Which of the following statements is correct?

- A. The accounting analysis follows the financial analysis
- B. The prospective analysis precedes the strategy analysis
- C. The prospective analysis follows the financial analysis
- D. The financial analysis precedes the strategy analysis

Q1.15. The outcomes of the strategy analysis affect the accounting analysis because

- A. The strategy analysis also includes an analysis of the firm's accounting strategy

- B. Firms with poor strategies are more likely to have low-quality financial statements than firms with successful strategies
- C. A firm's industry and competitive strategy affect which accounting choices are appropriate.
- D. None of the above.

Q1.16. Two reasons for why financial statements tend to be less useful in the analysis of privately held businesses than in the analysis of publicly held businesses (within the EU) is that

- A. (i) Private firm's financial statements are strongly influenced by tax rules and (ii) managers of private firms have less incentive to prepare informative financial statements than managers of public firms.
- B. Private firm's financial statements (i) do not comply with tax rules and (ii) are not publicly available.
- C. Private firm's (i) financial reporting is unregulated and (ii) financial statements are not publicly available.
- D. None of the above.

Answers:

- Q1.1: E,
- Q1.2: A,
- Q1.3: C,
- Q1.4: E,
- Q1.5: A,
- Q1.6: C,
- Q1.7: A,
- Q1.8: B,
- Q1.9: A,
- Q1.10: B,
- Q1.11: C,
- Q1.12: A,
- Q1.13: B,
- Q1.14: C,
- Q1.15: C,
- Q1.16: A.