

CONNECTING PREPARERS' AND USERS' DECISIONS

LEARNING OBJECTIVES

After completing this module you will be able to:

- Connect accounting preparers' and users' decisions in a framework that illustrates the intertwined consequences of their decisions.



Key take-aways:

- Companies report financial statements and other information to investors and stakeholders that affect companies' welfares. The preparers and users of these reports make decisions that are tightly intertwined and have consequences for all involved, including society.
- Companies are generally rewarded for performing well and thus have incentives to work as effectively and efficiently as possible towards this end. Companies that succeed have an incentive to honestly report their performance. Companies that perform poorly have an incentive to report fraudulently or otherwise mislead users.
- Adverse selection occurs when sellers know more than buyers about the quality of an item. It also occurs when preparers of accounting reports know more than users, thus investors can't distinguish reliable numbers from misleading ones.
- Companies that report competently and honestly and want their reports to be perceived credibly must work with users, standard setters, and others to separate the dispersion of experts' estimates from those of companies with poor investment potential.

Key terms:

- **Adverse selection**- Market process in which “bad” results occur when buyers and sellers have asymmetric information (i.e., access to different information): the “bad” products or customers are more likely to be selected.¹
- **Conflict of interest**- When an individual or organization is involved in multiple interests, one of which could possibly corrupt the motivation for an act in the other. Conflicts of interest can be any situation in which an individual or corporation (either private or governmental) is in a position to exploit a professional or official capacity in some way for their personal or corporate benefit. The presence of a conflict of interest is independent from the execution of impropriety. Therefore, a conflict of interest can be discovered and voluntarily defused before any corruption occurs.²

¹ “Adverse selection,” Wikipedia. 20 July 2010.

² “Conflict of interest,” Wikipedia. 20 July 2010.

