

FACTORS DRIVING DISPERSION OF MEASURES

LEARNING OBJECTIVES

After completing this module you will be able to:

- Understand the factors that drive the dispersion of ideal and actual measures.
- Qualitatively gauge the dispersion of actual reported measures and the confidence you should have when making decisions based on them.



Key take-aways:

- Ideal measures are those created by objective experts. Understanding what drives the dispersion of ideal measures can help you qualitatively gauge the dispersion of actual reported measures and the confidence you should have when making decisions based on them.
- Understanding the factors that drive dispersions can give you insights into the reasons generally accepted accounting principles (GAAP) restrictions exist and how the restrictions evolve over time as the factors that affect the dispersions change. This in turn, can help you gauge how close reported numbers are to the ideal measures that would have been reported if there were no GAAP restrictions and all preparers were objective experts.
- Factors that affect the dispersions of ideal measures also affect the dispersions of actual measures: Measurement objective, scope, method, and uncertainty about the method's inputs, which depends on: uncertainty about related events and circumstances (business risks) and the availability and reliability of comparable market, time-series, or cross-sectional benchmark data.
- Other factors that affect actual measures help honest preparers avoid unintentional errors and discipline preparers not to act on incentives to report dishonestly when given opportunities to do so.
- Analysts push their analyses beyond what they see on the surface, the actual reported measures. First, they dig deeper into the accounting judgments behind the numbers by learning the related measurement procedures and assessing the extent to which judgment was required. They also assess the business judgments and risks behind the numbers. These deeper accounting and business analyses allow analysts to assess the confidence they should have in the numbers when using them for their decisions.

- The more you understand the accounting issues and underlying measurements, judgments, and risks, the deeper your analysis and interpretation of a company's financial condition. Fortunately, companies identify measures that require judgment in footnotes in their annual reports. In fact, those that involve considerable judgments and have a significant impact on a company's financial statements are identified as "Critical Accounting Estimates." More generally, companies discuss other judgments that are less consequential in their "Accounting Policies" footnotes.