

ENGLISH TEST

INSTRUCTIONS: In questions **01** to **05** you will be asked about some detailed information and the overall meaning of **TEXT 1**. Read **TEXT 1** and the questions about it carefully. Choose the best answer based on what is written or suggested in **TEXT 1**.

Accuracy in earnings forecast and organizational life cycle stages: evidences in the Brazilian capital market

1 (1) The determinants of the accuracy of analysts' forecasts are due to characteristics related to analysts' experience and coverage, brokerage size, firm size, and corporate governance. Nevertheless, in a current scenario of ongoing crises and constant changes in firms, there is a need to find the influence of internal and external environmental factors, such as life cycle stages (LCSs) in the accuracy of analysts' earnings predictions.

5 (5) The Business Life Cycle theory, which guides this study, can present aspects of businesses' evolution, showing an alternative economic scenario, motivated by internal environmental factors, such as the adopted strategy, financial slack, management capacity, among others, and external environmental factors such as corporate competition and macroeconomics (Costa, 2015). Thus, growth tactics and the ability to raise capital can vary in distinct stages of a company's life cycle, which can be divided into five phases: birth, growth, (10) maturity, turbulence, and decline (Mueller, 1972; Dickinson, 2011). Thus, for each stage of the life cycle, the analysts are expected to behave differently.

 In the birth stage, the firm's value depends entirely on its future growth potential. Thus, estimates are prone to error due to the context of uncertainties (Miller & Friesen, 1984; Costa, 2015). According to Dickinson (2011) and Hribar and Yehuda (2015), mispricing occurs throughout the life cycle, but is especially perceived (15) during the first stages when the signs of different performance measures are more distinct. In addition, there is little publicly available information about these new companies. Thus, there is more privileged information, which tends to increase uncertainty, hindering the analysts' accuracy (Girão, 2016).

 In the growth stage, the valuation is still limited and unreliable, which may compromise the accuracy of analysts' forecasts (Costa, 2015; Koh, Dai & Chang, 2015). In this phase, the forecasting difficulty is increased (20) and, so, the costs and efforts for analysts to follow the companies in the growth phase are increased (Hamers, 2017). In addition, the reduced visibility of firms in the growth phase may limit the benefits of analysts that could derive from these firms' coverage (Bushee & Miller, 2012).

 At maturity, in turns, analysts tend to make more correct forecasts, as firms are less prone to the predictability risk (Costa, 2015). Mature companies have a stable operating environment, reflected in persistent (25) profits, thereby easing analysts' ability to predict future performance more easily (Easley & O'Hara, 2004, Donelson & Resutek, 2015). Mature companies do not have many investments to make, nor are they likely to default (life cycle classification based on cash flow signs evidences this), making profit more predictable when compared to the first stages.

 In the turbulent stage, accounting information loses relevance and may undermine the analysts' (30) performance. Companies in turbulence can migrate to earlier stages, deploy innovative ideas, or improve their efficiency, or they can move into the decline stage. Little is known about these companies though, leading to uncertainty about the implications for the financial analysts' difficulties (Girão, 2016).

Finally, in the decline stage, analysts' earnings forecast tends to be easier because they are based on existing assets and past practices (Damodaran, 2012). Thus, due to the visibility of these companies and the (35) analysts' greater knowledge, this stage tends to present more accuracy. Investors need to know how long these 35 companies will be able to continue the activity or whether they will be able to pay dividends (Girão, 2016). Therefore, the analysts' monitoring should be more prioritized, also easing the accuracy of the earnings.

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1. Regarding lines 01 – 12, choose the correct statement:

- A) A company's life cycle sets up the ability to raise capital.
- B) The analysts' experience and coverage, brokerage size, firm size, and corporate governance are examples of firms' strategies to find internal and external environmental factors.
- C) Internal environmental factors, such as the adopted strategy, financial slack, management capacity, among others, and external environmental factors, such as corporate competition and macroeconomics, discourage an alternative economic scenario.
- D) The need to find the influence of internal and external environmental factors derives from the lack of comprehension of a company's life cycle stages.
- E) Each stage of a company's life cycle influences growth tactics and the ability to raise capital.

ANSWER KEY:

- A) (Incorrect) – Lines 09 and 10. The ability to raise capital can vary in distinct stages of a company's life cycle; however, the phases themselves do not set up that ability.
- B) (Incorrect) – The text does not mention that.
- C) (Incorrect) – It is the opposite. Lines 05 to 08.
- D) (Incorrect) – The need derives from the necessity to determine accurate earning predictions. Lines 03 and 04.
- E) (Correct) – Line 08.

2. According to lines 13 – 18, why are estimates prone to error at a firm's birth stage?

- A) Due to mispricing.
- B) Due to imprecise circumstances.
- C) Due to achievement measures.
- D) Due to publicly data.
- E) Due to private reports.

ANSWER KEY:

- A) (Incorrect) – The text does not mention it.
- B) (Correct) – Line 13
- C) (Incorrect) – The text does not mention it.
- D) (Incorrect) – The text does not mention it.
- E) (Incorrect) – The text does not mention it.

3. Based on lines 19 – 29, mark the false alternative:

- A) In the maturity stage, earnings predictions accuracy come from a stable operating environment.
- B) Investments are less likely to be needed or neglected in mature companies.
- C) Forecasting is more complex in the growth stage than in the birth stage.
- D) Profit predictions lose importance once companies have reduced visibility.
- E) In the growth stage, firms' valuation is still dubious, which limits the accuracy of earnings predictions.

ANSWER KEY:

- A) (Correct) – Lines 24 and 25.
- B) (Correct) – Lines 26 and 27.
- C) (Correct) – Lines 19 and 20.
- D) (Incorrect/False) – The text does not mention that.
- E) (Correct) – Lines 20 and 21.

4. In which phase are earnings forecast less pertinent?

- A) In the growth stage
- B) In the maturity stage
- C) In the decline stage
- D) In the birth stage
- E) In the turbulence stage

ANSWER KEY:

- A) (Incorrect) – Earnings forecasts are more difficult at this stage. Fourth paragraph.
- B) (Incorrect) – Earnings forecasts tend to be more correct at this stage. Fifth paragraph.
- C) (Incorrect) – Earnings forecast are easier at this stage. Seventh paragraph.
- D) (Incorrect) – Earnings forecasts are prone to error at this stage. Third paragraph.
- E) (Correct) – Lines 29 and 30. “In the turbulent stage, accounting information loses relevance and may undermine the analysts' performance.”

5. The expression *deploy innovative ideas*, in line 30, cannot be replaced by:

- A) Expand
- B) Set up
- C) Conceal
- D) Unfold
- E) Induce

ANSWER KEY:

- A) (Incorrect) – Synonym
- B) (Incorrect) – Synonym
- C) (Correct) – Antonym. Conceal means hide.
- D) (Incorrect) – Synonym
- E) (Incorrect) – Synonym

INSTRUCTIONS: In questions **06** to **10** you will be asked about some detailed information and the overall meaning of **TEXT 2**. Read **TEXT 2** and the questions about it carefully. Choose the best answer based on what is written or suggested in **TEXT 2**.

TEXT 2

Actuarial fairness in social security calculations: application of a multiple decrement model to compare the social security factor and minimum age rules

1 (1) On December 5th, 2016, the head of the Executive sent the Proposed Constitutional Amendment (PCA) n. 287 (Brazil, 2016) to the Chamber of Deputies, aiming to set out a new framework for social security, establish transitional rules, and make other provisions, based on the reason that such changes are needed for fiscal adjustment in Brazil. This proposed reform is based on the demographic changes that have occurred in the
5 (5) country in recent years and on the pressure they have exerted on the solvency of the Brazilian social security system, with the key point being the adoption of a progressive minimum retirement age.

Meneu, Devesa, Devesa, Dominguez, and Encinas (2016) note that introducing automatic adjustment mechanisms that can respond to changes in variables (particularly demographic ones) that affect the sustainability of social security rules has become a trend in reforms to social security systems. Also, according to the authors,
10 (10) these automatic mechanisms are nothing more than normative instruments that regulate the value of certain parameters in accordance with variations in pre-defined indicators, with the aim of maintaining the solvency of the social security system without the need for new reforms. Two of the automatic adjustment mechanisms that stand out are the reduction factors (such as the social security factor) that alter the value of retirement benefits in accordance with variations in some demographic indicator (in particular, life expectancy) and those that associate
15 (15) retirement age with life expectancy (as in the case of adopting a progressive minimum retirement age).

In Brazil, according to article 194 of the 1988 Federal Constitution (FC/88) (Brazil, 1988), social security is composed of three public authority initiatives: Health, Welfare, and Pensions, whose form of funding is defined in article 195 of the FC/88. Regarding pensions, this is divided into three pillars: the General Social Welfare Policy (GSWP), for which affiliation is obligatory for Brazilian workers ruled over by the Consolidation of Labor
20 (20) Laws and whose pension cover is guaranteed by the federal government and operated by the National Social Security Institute (INSS), which charges employers and employees monthly contributions to guarantee this assistance; the Special Social Welfare Policy (SSWP), for which affiliation is also obligatory for public servants holding effective positions (whether with the Union, state, Federal District, or municipality); and the Complementary Pension Scheme (CPS), which is facultative and can be operated by open or closed
25 complementary pension entities.

Considering the uncertainty caused by pension reform, workers may ask whether the contributions made in their favor over the course of their working lives – so that they have the right to pension cover – are charged in an actuarially fair way. An actuarially fair value is understood as being one for which the expected contributions are equal to the expected benefits. In this spirit, based on the principle of mutualism, workers would
30 (30) imagine themselves in a capitalization scheme and compare the expected costs needed to have the right to the possible pension benefits with the current rates charged by the State.

6. Regarding lines 1 – 15, mark the F (false) statement:

- A) The adoption of a progressive minimum retirement age forms one of the most important aspects of the proposed reform.
- B) The proposal of Fiscal Adjustment in Brazil is due to demographic changes which have negatively affected the solvency of the national social security system.
- C) Automatic adjustments which alter the value of retirement benefits according to variations in demographic indicators constitute the correct parameter for Brazil.
- D) Automatic adjustments which associate retirement age with life expectancy are used when a progressive minimum retirement age is set up.
- E) Automatic adjustment mechanisms intend to regulate the solvency of the social security system without the need for new reforms.

ANSWER KEY:

- A) (Correct) – Line 06.
- B) (Correct) – Lines 04 to 06.
- C) (Incorrect/False) – The text does not mention that.
- D) (Correct) – Lines 14 and 15.
- E) (Correct) – Lines 11 and 12.

7. According to lines 07 – 15, what is the main goal of automatic mechanisms?

- A) To sustain the ability to pay social security benefits.
- B) To keep the ability to alter the value of retirement benefits.
- C) To regulate demographic indicators.
- D) To avoid changes in variables.
- E) To regulate reduction factors.

ANSWER KEY:

- A) (Correct) – Lines 11 and 12 “...with the aim of maintaining the solvency of the social security system without the need for new reforms.”
- B) (Incorrect) – Important factor but does not constitute the main goal.
- C) (Incorrect) – Important factor but does not constitute the main goal.
- D) (Incorrect) – Important factor but does not constitute the main goal.
- E) (Incorrect) – Important factor but does not constitute the main goal.

8. Based on lines 16 – 25, choose the correct alternative:

- A) The Complementary Pension Scheme (CPS) must be paid by public servants holding effective positions.
- B) Health, Welfare, and Pensions are the three pillars of private social security.
- C) Public servants may affiliate to the Special Social Welfare Policy (SSWP).

- D) The General Social Welfare Policy (GSWP), the Special Social Welfare Policy (SSWP), and the Complementary Pension Scheme (CPS) constitute the pillars by which funding for pensions are guaranteed.
- E) Brazilian workers ruled over by the Consolidation of Labor Laws pay monthly contributions in case they want to have pension cover by the federal government.

ANSWER KEY:

- A) (Incorrect) – It is a facultative choice. Lines 24 and 25.
- B) (Incorrect) – they are the pillars of public social security. Line 17.
- C) (Incorrect) – Affiliation is mandatory for public servants. Line 22.
- D) (Correct) – Line 18.
- E) (Incorrect) – Monthly contributions are mandatory, regardless of the worker's desire. Lines 19 and 20.

9. Regarding pension concerns, what does actuarially fair value mean?

- A) The right to pension cover.
- B) The right to contribute during the working life.
- C) The principle of mutualism.
- D) The principle of contribution.
- E) The right to be in a capitalization scheme.

ANSWER KEY:

- A) (Incorrect) – Important factor, but it does not describe what actuarially fair value mean.
- B) (Incorrect) – The text does not mention that.
- C) (Correct) – Lines 28 and 29. “An actuarially fair value is understood as being one for which the expected contributions are equal to the expected benefits (...), based on the principle of mutualism.
- D) (Incorrect) – Important factor, but it does not describe what actuarially fair value mean.
- E) (Incorrect) – Important factor, but it does not describe what actuarially fair value mean.

10. The word *current*, in line 31, cannot be replaced by:

- A) Former
- B) Ongoing
- C) Present
- D) Existent
- E) Ruling

ANSWER KEY:

- A) (Correct) – Antonym (opposite meaning).
- B) (Incorrect) – Synonym
- C) (Incorrect) – Synonym
- D) (Incorrect) – Synonym
- E) (Incorrect) – Synonym