

Accounting & Auditing Research: Tools and Strategies

9th Edition

SOLUTIONS MANUAL

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CHAPTER 1

INTRODUCTION TO APPLIED PROFESSIONAL RESEARCH

Discussion Questions

1. Research in general involves the investigation and analysis of an issue in question. The researcher usually applies reasonable and reflective thinking to develop an answer to the issue or problem at hand. Research requires a clear definition of the problem, using professional databases to search the authoritative literature, reviewing and evaluating the data collected, drawing conclusions and communicating your results.
2. Accounting, auditing, or tax research involve a systematic and logical investigation of an issue or problem using the accountant's professional judgment. Furthermore, accountants approach this problem using critical-thinking skills to obtain and document evidence underlying a conclusion relating to an issue or problem currently confronting the accountant or auditor.
3. Accounting, auditing, or tax research are necessary in order to determine the proper recording, classification, and disclosure of economic events; to determine compliance with authoritative pronouncements; or to determine the preferability of alternative accounting procedures.
4. The objective of accounting, auditing, or tax research is a systematic investigation of an issue or problem utilizing the researcher's professional judgment to arrive at appropriate and timely conclusions regarding the issues at hand.
5. Research plays an important role within an accounting firm or department. It is critical for the accountant/auditor to be able to find and locate applicable authoritative pronouncements and to ascertain their current status. Given the number and diversity of clients served, public accounting firms constantly engage in research on a wide array of accounting, auditing, or tax issues. This

research process is usually conducted by the local office staff, selected local or regional "research specialists," and/or the executive office research personnel.

6. The functions of a multi-office CPA firm's Policy Committee are to evaluate significant accounting and auditing issues and establish firm-wide policies on these issues. Its Executive Subcommittee handles daily ongoing policy (i.e., lower-level) decisions for the firm as a whole.

7. Some basic questions that the researcher must address in performing, accounting, auditing, or tax research include: Do I have the knowledge to do the research?; What is authoritative literature?; Does authoritative literature address the issue?; If authoritative literature does exist, where can I find it?; If there exist more than one alternative of authoritative support, which one do I use?; If authoritative literature does not exist, what do I do?; What professional databases do I use?

8. Theoretical (pure or basic) research involves investigating questions that, while interesting, have little or no present, practical applications; while applied research involves investigating issues of immediate, practical importance.

9. Some of the characteristics that a practitioner-researcher should possess include inquisitiveness, open-mindedness, patience, thoroughness, and perseverance.

10. The "Research Navigation Guide" serves as a tool in navigating through the authoritative literature. The guide helps to focus or narrow one's research when utilizing various databases like the FASB's Codification System. One would first focus on a functional area like "Financial Accounting". Once the functional area is identified then focus on the broad categorization of the topic such as "Revenue". This is followed by focusing on the subtopic that allows for further segregation of the issue "Software Revenue". The final step would be to focus on the section or nature of the content of the issue which is often a recognition, measurement, or disclosure issue such as "Recognition of Software Revenue".

11. While a priori (before the fact) research refers to research before the client actually enters into the (proposed) transaction, a posteriori (after the fact) research refers to research relating to past or completed economic transactions. For planning purposes, the practitioner would rather be involved with a priori research to work with the client to develop a correct solution rather than attempting to correct a completed transaction.

12. The California court decision stresses that "well-informed" accountants are expected to master "standard research techniques" (or face severe malpractice claims).

13. The research process "adds value" to an accounting firm's services, since today's complex business transactions and proliferation of new authoritative pronouncements mandates that the firm efficiently and effectively conduct such research for their clients.

14. Some economic consequences to the standard-setting process of performing research include the impact of such pronouncements to investors and creditors resource allocation decisions in

today's (competitive) capital markets, and the cost/benefit analysis of the issuance of a new standard.

15. Since the accounting and auditing literature is organized with a keyword indexing system, listing keywords in step one of the research process will aid the researcher in locating the authoritative literature in an efficient and effective manner. Failure to describe the keywords in sufficient detail can cause one to overlook important sources.

16. The five steps involved in the research process include: identifying the (research) issue, collecting the (appropriate) evidence, evaluating the results and identifying alternative solutions, developing (appropriate) conclusions, and communicating the results to the interested parties.

17. Research can support or refute a biased alternative by gathering evidence that is either unbiased or slanted toward the alternative being researched. Since the researcher should be unbiased in evaluating the various alternatives, the process often requires a (detailed and logical) analysis of complex and detailed accounting issues--thereby requiring "critical thinking" skills.

18. Problem distillation entails "refining" and "restating" the research issue from general to sufficiently specific terms, in order not to waste time investigating irrelevant items.

19. The skills tested on the CPA exam include: understanding, analysis, judgment, communication, **research**, and synthesis.

20. A research memorandum should contain such attributes as selecting objective and unbiased words; a grammatically correct and well-spelled, clear statement of the issue researched; a statement of the facts; a brief and precise discussion of the issue; and a straightforward conclusion based upon supported and identified authoritative literature.

The researcher should avoid making such common errors as excessive discussion of the issues and facts, excessive citations to authoritative sources, avoidance of presenting a conclusion, and including irrelevant information.

21. Critical-thinking skills (e.g., understanding a variety of contents and circumstances and applying various accounting, auditing, and business principles to help solve the problem under review) helps the researcher effectively and efficiently gather relevant facts, synthesize and evaluate alternatives, and develop alternative solutions.

22. The SEC stressed the importance of accountants performing effective research, claiming that this CPA's deficiency constituted a lack of exercising "due professional care."

23. Although this question is raised in Chapter 1, it is not directly answered until a later chapter. However, in Chapter 1 it briefly discusses that when authoritative literature does not exist on a specific issue, the practitioner would normally develop a theoretical solution based on logic or analogous authoritative literature. In a later chapter we will focus on this question in detail whereby one utilizes the "FASB's Conceptual Framework" and other authoritative literature by analogy to solve the problem.

24. The standard setter for accounting standards for federal government entities is the Federal Accounting Standards Advisory Board (FASAB). The PCAOB does not set accounting standards, but auditing standards.

25. Since you are conducting accounting research for a public company (Microsoft), the researcher would utilize the standards of the FASB located on the FASB Codification database which is the focus of Chapter 4. This database also includes the authoritative standards of the AICPA. GAO and PCAOB standards are auditing standards, not accounting standards.

26. Qualitative analytics focuses on non-quantitative data such as videos, pictures, or an entity's e-mails. Whereas quantitative analysis focuses on the analysis of numerical data such as trends of dollar sales and focusing on the outliers.

27. Data analytics is considered a process of inspecting, cleansing, transforming, and modeling data with the goal of discovering useful information, suggesting conclusions, and supporting decision-making.

28. Examples of structured data would be data found in excel spreadsheets. Examples of unstructured data would include pictures, videos, or Twitter feeds.

Exercises

1. Current Quality Control standards of the PCAOB include:
QC 20- System of QC for a CPA Firm's Accounting & Auditing Practice.
QC 30- Monitoring a CPA Firm's Accounting & Auditing Practice
QC 40- the personnel Management Element of a Firm's QC Competencies.
2. The IASB is the independent, accounting standard setting body that issues international financial reporting standards (IFRS) which are discussed in Chapter 5.
3. Recent IAASB standards include:
ISA (Revised)- Consideration of Laws & Regulations in an Audit of Financial Statements.
ISA 810 (Revised)-Engagements to Report on Summary Financial Statements
4. Two publications of the AICPA include publications related to Accounting & Auditing and Business Valuation, as well as other publications listed at the AICPA's website.
5. **Student Cases with Solutions to accompany Accounting & Auditing Research: Tools & Strategies (9th edition)**
6. **NOTE: In addition to the text's exercises and problems, this file presents several short cases for students to access the authoritative literature or other relevant sources to address a particular issue. After each case is presented, the solution appears in color.**

Other excellent sources of longer cases include the "Deloitte Trueblood case studies"

from the Deloitte Foundation, as well as the “Accounting Professor’s Curriculum Resource” from the AICPA.

7. Topical Index of Cases for Students

- 8.
9. **INTERMEDIATE ACCOUNTING Cases**
- 10.
11. Case 1: Reporting acquisition and repayment transactions in the Statement of Cash Flows
12. Case 2: Recording a forfeited payment
13. Case 3: Revenue and expense recognition associated extended warranties
14. Case 4: Accounting for “due on demand” note payable
15. Case 5: Purchase of a controlling interest with a greenmail premium
16. Case 6: Revenue recognition in the construction industry
17. Case 7: Accrual and measurement of interest payments
18. Case 8: Recognition of an asset transfer when title has not yet been received
19. Case 9: Capitalization of interest and property taxes on a construction project
20. Case 10: Deferred compensation and life insurance policy recognition
21. Case 11: Reporting earnings per share balances for subsidiary companies
22. Case 12: Deferral of lease payments
23. Case 13: Disclosure of prior period adjustments in the statement of cash flows
24. Case 14: Measurement and recording of payments for sick days
25. Case 15: Comparative cash flow statements
26. Case 16: Social security benefits as assets
27. Case 17: Recording a stock dividend as a stock split
28. Case 18: Gain on a nonmonetary exchange
29. **ADVANCED ACCOUNTING Cases**
30. Case 1: Reporting of letters of guarantee notes payable
31. Case 2: Factors affecting minority interest control
32. Case 3: Profits and losses in the investment in foreign currencies
33. Case 4: Amortization of foreign currency transaction gains and losses
34. Case 5: Reflection of expensed computer programs on consolidated financial statements
35. Case 6: Classification of a proposed financial instrument as a hedge
36. Case 7: Disclosure of proceeds and payments from cash flow hedging activities
37. Case 8: Proper valuation of a “guaranteed” business combination
38. **GOVERNMENT AND NOT-FOR-PROFIT ACCOUNTING Cases**

- 39. Case 1: Recognition restricted or non-restricted assets that are promised but not received
- 40. Case 2: Affect of “permanent” reductions in the value of “promised” assets
- 41. Case 3: Disclosure and classification on a company’s Statement of Cash Flows
- 42. Case 4: Disclosure of potential interest rate swings and commercial paper by a city
- 43. Case 5: Capital and operating leases between related parties
- 44. Case 6: Elimination of profits on intercompany sales
- 45. Case 7: Accrual of vacation time of unestablished employees

46. AUDITING Cases

- 47. Case 1: Communication with predecessor auditors
- 48. Case 2: Interim Financial Statements
- 49. Case 3: Outside services for inventory counts
- 50. Case 4: Service Organizations
- 51. Case 5: Liquidation Basis of Accounting
- 52. Case 6: Re-issuance of financial statements
- 53. Case 7: Qualified report and account classification
- 54. Case 8: Reporting on financial statements including accompanying information
- 55. Case 9: Accounting for assets held for sale

56. TAX Problems and Cases

- 57. Tax Problems (students look up various sources)
- 58. Tax Case 1: When should gross income be accrued? (Basic)
- 59. Tax Case 2: Stock Purchased by an Employee (Intermediate)
- 60. Tax Case 3: Business Deductions (Intermediate)
- 61. Tax Case 4: Deduction for Foreign Travel (Intermediate)
- 62. Tax Case 5: Income Sourcing – International Tax (Advanced)
- 63. Tax Case 6: Contingent Liabilities in a Tax-Free Transfer (Advanced)

64. MISC. RESEARCH Cases

- 65. Case 1. Apple Proxy Case
- 66. Case 2. Fifth Largest Fortune 500 Company
- 67. Case 3. Finding an Article on Corporate Governance Challenges
- 68. Case 4. Automotive Industry and Tesla
- 69. Case 5. Dodd-Frank and Corporate Governance Reforms
- 70. =====

71. INTERMEDIATE ACCOUNTING Cases

72. **Case 1:** Mead Motors purchases an automobile for its new car inventory from Generous Motors, which finances this transaction through its financial subsidiary, Generous Motors Credit Company (GMCC). Mead pays no funds to Generous Motors or GMCC until it sells the automobile. Mead must then repay the balance of the loan plus interest to GMCC. How should Mead report the acquisition and repayment transactions in its Statement of Cash Flows?

73. Case 1 Solution:

74. Problem Identification: How should a company report, if at all, cash and non-cash transactions owed to an entity's financial subsidiary?

75. Keywords: Cash flows; financ* subsidiaries; operating income.

76. Conclusion: Per ASC 230-10-50-5, Mead should exclude transactions that involve no cash payments or receipts. However, per 230-10-45-17, it should record cash payments to GMCC for repayments of principle (and interest thereon) due to suppliers or their subsidiaries as operating cash (out) flows.

77. **Case 2:** Narda Corporation agreed to sell all of its capital stock to Effie Corporation for three monthly payments of \$200,000. After Effie made the first required payment, it ceased making other payments. The stock subscription agreement states that Effie, thus, forfeits its payments and is entitled to no other future consideration. How should Narda record the \$200,000 forfeited payment?

78. Case 2 Solution:

79. Problem Identification: How should a company account for forfeited stock subscriptions? Moreover, do such payments constitute operating or other income?

80. Keywords: Stock Subscription; operating income; additional paid-in capital; owners' equity; net income; operating income.

81. Conclusion: Per 505-10-25-2, capital transactions that incur no future corporate obligations should be excluded from calculating net or operating income. Thus, the forfeited cash should become part of additional paid-in capital about any required disclosures for such transactions.

82.

Case 3: Lowland Appliance Stores offers customers purchasing its appliances separately priced (extended) warranties. Lowland services these extended warranties. Its customers can receive no refunds for not using these warranties, and, of course, Lowland must honor these contracts—regardless of any future costs in doing so. It also “tracks” the profits and losses these types of warranties generate by appliance category—in order to

help maintain a competitive price and costing structures. How should Lowland recognize the revenues and expenses of such extended warranties?

83. Case 3 Solution:

84. Problem Identification: How should a company recognize revenues and expenses associated with separately priced, extended warranties? Such contracts generally are (potential) loss contingencies.

85. Keywords: Loss contingency; non-refundable

86. Conclusion: Per 605-20-25-3, such extended warranties constitute “product maintenance contracts,” where Lowland agrees to perform certain agreed-upon services to these products for a specific time period. As such, it should recognize revenue on a straight-line basis over the contract period, unless sufficient historical evidence indicates a superior alternative method of doing so. Lowland should also “match” any related costs in the same time period as the associated revenues. Moreover, Lowland should recognize a loss on such contracts that have an expected net cumulative loss over the remaining contract periods. Further information on this topic also appears in 450-20-05-3 and 460-10-25-5; FASB Concepts Statement No. 5, pars. 83 and 84; and FASB Concepts Statement No. 6, par.197.

87. Note: ASU 2014-09 supersedes solution 2018 – transition 606-10-65-1