Accounting & Auditing Research: Tools and Strategies

7th Edition

SOLUTIONS MANUAL

Thomas R. Weirich, PhD, CPA
Thomas Pearson, LL.M., J.D., CPA
Natalie Churyk, PhD, CPA

CHAPTER 1
INTRODUCTION TO 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.
CHAPTER 2
CRITICAL THINKING and EFFECTIVE WRITING SKILLS
FOR THE PROFESSIONAL ACCOUNTANT

Discussion Questions:

1. Critical thinking has many definitions. One definition is as follows: Critical thinking involves a process of (more deeply) understanding, evaluating, and judging the underlying issues under investigation.

2. The highest level of thinking according to Bloom’s taxonomy entails the "evaluation” of a statement (based upon definite criteria) for a given purpose.

3. In Bloom’s taxonomy, comprehension (or grasping the meaning of a statement) entails the ability of restating the item into the researcher’s own words without changing the statement’s meaning--thereby entailing a higher order skill than merely paraphrasing it.

4. While critical thinking involves a process of (more deeply) understanding, evaluating and judging the underlying issues under investigation, professional skepticism entails an attitude of examining and recognizing emotional-laden, and explicit and hidden assumptions “behind” each question.

5. The qualities that lie behind rethinking include: a willingness to say that you don’t know the answer, an openness to alternatives, an interest in the ideas of others, thoughtfulness, a desire to discover what others have done and thought, an insistence on getting the best evidence, and an openness to one’s own intuition.

6. The three levels of thought by the Illinois Renewal Institute include: Recall--the lowest level, where one defines, describes, lists, recites or selects; Process--the second level, where one compares, contrasts, classifies, sorts, and analyzes; and Application--the highest level, where one evaluates, imagines, judges, and hypothesizes.

7. The AICPA’s list of effective writing characteristics include a coherent organization, conciseness, clarity, use of standard English, responsiveness to the requirements of the question, and appropriateness for the reader. The editing skills include conciseness, clarity, and the use of standard English. The composing skills include organization, responsiveness, and appropriateness.

8. Per SEC Rule # 33-7380, six principles of clear writing include using:
   a. Active voice;
   b. Short sentences;
c. Everyday language;
d. Tabular presentation of complex material;
e. No legal jargon; and
f. No multiple negatives.

9. Plain English writing does **not** mean deleting complex information. Rather, it presents documents in an orderly and clear fashion so the reader can better understand it.

10. The elements of plain English include: Know your audience; know what material information needs to be disclosed; use clear writing techniques; and design and structure the document for ease of readability.

11. The active voice uses strong, direct verbs. The subject of the sentence performs the action described by the verb. An example: “I will respond to the client’s memo.” The passive voice is where the action is done to somebody or something by another agent. The passive voice often uses the words “be” or “been.” An example: “No one has been authorized to respond to the client’s memo.”

12. Special concerns of using e-mails include the need to develop strong writing skills as one attempts to state his or her thoughts as concisely as possible; and strong technological skills in the security of the transmission of the communication.

13. The different types of client letters include: transmittal letters that merely transmit information; status update letters that reminds the client about a situation by providing an update to the issue; action request letter requests action; and an opinion letter summarizes the situation very briefly.

14. A memo to the file documents the reasoning for one’s conclusion that might be related to a research issue. A client letter normally does not document the details of the research process.

15. A tax memo is often unique in that it usually includes the reasoning for the law or authorities used, as well as the application of the law or authorities to the client’s set of facts. The memo would include the following areas: Facts, Issues, Conclusion, and Reasoning. Chapter 7 will provide greater details as to tax issues and memoes.

**Exercises:**

1. The solution to this logic problem is the following:

<table>
<thead>
<tr>
<th></th>
<th>House 1</th>
<th>House 2</th>
<th>House 3</th>
<th>House 4</th>
<th>House 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Color</td>
<td>Yellow</td>
<td>Blue</td>
<td>Red</td>
<td>White</td>
<td>Green</td>
</tr>
<tr>
<td>Country</td>
<td>America</td>
<td>Russia</td>
<td>England</td>
<td>Spain</td>
<td>Japan</td>
</tr>
</tbody>
</table>
2. The eight elements of reasoning as to the question of when assets need to be classified as current assets are as follows:
   a. Purpose—the purpose is to respond to the client’s request for information.
   b. Issue—the issue is to provide a specific response to the question, "When do assets need to be classified as current assets?"
   c. Information—the information for this issue would include the authoritative accounting literature.
   d. Concepts—the concepts would include the concepts (definition) of an asset, and the classification between current and long-term assets.
   e. Assumptions—the assumption to classify an asset as current is that it will be used up, or consumed within one year or the operating cycle, whichever is longer.
   f. Interpretations or inference—the interpretation requires one to determine from the evidence whether the asset will be used up or converted into cash.
   g. Implications or Consequences—If an asset is not properly classified, the analysis of the financial statements (i.e., current ratio) would be misleading.
   h. Solution—An asset should be classified as a current asset when it will be converted into cash, or consumed in operations within one year or the operating cycle, whichever is longer.

3. The eight elements of reasoning for the question of when a contingent liability should be booked are as follows:
   a. Purpose—the purpose is to respond to the client’s request for information.
   b. Issue—the issue is to provide a specific response to the question, "When should a contingent liability be recorded?"
   c. Information—the information for this issue would include the authoritative accounting literature.
   d. Concepts—the concepts would include the concepts (definition) of a contingent liability, and when to record a liability.
   e. Assumptions—the assumption to record a contingent liability would be that the dollar amount can be estimated and the liability is probable in occurrence.
   f. Interpretations or inference—the interpretation requires one to evaluate the probability of occurrence and whether the amount can be reasonably estimated.
   g. Implications—If a contingent liability meeting the requirements of FASB No. 5 is not recorded, then the financial statements are misstated.
   h. Solution—a contingent liability should be recorded if it meets the two criteria of FASB No. 5—probable and the amount can be reasonably estimated.

4. Correct punctuation:
a. A general ledger contains all the assets, liabilities, and owners’ equity accounts.

b. The purpose of a trial balance is to prove that debits equal credits, but this does not prove that all transactions have been recorded.

c. The current assets section of the balance sheet contains items such as cash, accounts receivable, and prepaid expenses; and the current liabilities section contains items such as accounts payable, notes payable, and short-term debt.

d. The auditing exam was to begin at 2:00 p.m., but the professor’s car broke down, so we didn’t begin until 2:30 p.m.

e. Did William ask, “How can we finish the audit tonight because Linda said, ‘We have twenty hours of work left to do’”?

5. Examples of the sentences rewritten:

   a. Original sentence:
      For good reasons, the secretary may grant extensions of time in 30-day increments for filing of the lease and all required bonds, provided that additional extensions requests are submitted and approved before the expiration of the original 30 days or the previously granted extension.

   rewritten:
      We may extend the time you have to file the lease and required bonds. Each extension will be for a 30-day period. To get an extension, you must write us giving the reasons that you need more time. We must receive your extension request in time to approve it before your current deadline or extension expires.

   b. Original sentence:
      If the State agency finds that an individual has received a payment to which the individual was not entitled, whether or not the payment was due to the individual’s fault or misrepresentation, the individual shall be liable to repay to the State the total sum of the payment to which the individual was not entitled.

   rewritten:
      If the State agency finds that you received a payment that you weren’t entitled to, you must pay the entire sum back.

   c. Original sentence:
      Universities differ greatly in style, with some being located on out of town campuses in parkland, others having buildings scattered about parts of city centers and others being at various points between these two extremes.

   rewritten:
      Universities differ greatly in style. Some are located on out of town campuses in parkland. Others have buildings scattered about parts of city centers. Others are at various points between these two extremes.

6. Multiple Negatives sentence rewritten:
Original sentence:
No termination will be approved unless the administrator reviews the application and finds that it is not lacking any requisite materials.

Rewritten:
Termination will be approved if the administrator finds the application to contain all requisite materials.

7. Active Voice sentences rewritten:

a. Original sentence:
The fraud was reported by the employee.

Rewritten sentence:
The employee reported the fraud.

b. Original sentence:
The book was enjoyed by me because the seven fraud investigation techniques were described so well by the author.

Rewritten sentence:
I enjoyed the book because the author described the seven fraud investigation techniques so well.

8-a. By keeping $20, the bellboy changed the auditors’ rate to $270 ($250 actual + $20 stolen). The $20 should have been subtracted from the $270 rather than added! The $300 is composed of the $250 cost, the $30 refund, and the $20 stolen.

8-b. This question involves critical thinking that will vary between students and therefore does not have a right answer. Some potential answers to the given questions include:

1) An asset “stays” as an asset as long as it generates future cash inflows to the company. Thus, an obsolete machine that continually requires much labor and other maintenance costs to keep operating could well be considered a liability—especially if cheaper technologies have arisen.

2) (Part 1) While financial statements may not report certain assets and liabilities, such as human resources (employees), or the benefits of high employee morale, the more critical question is if the presented financial statements provide useful information to decision makers: i.e., can such decision makers make more informed decisions when they use such statements than they would have if these statements were unavailable? (Part 2) Similarly, financial statements that present assets at historical costs—rather than at fair market values—should provide more meaningful information than not reporting statements that follow GAAP. Moreover, the objectivity of assets reported at historical costs usually supersedes those presented at current value.
3) A liability should normally be first reported when the entity can reasonably measure the expected cash outflows associated with a financial transaction or event (and stop recognizing such liabilities when the entity can no longer meet these “reasonably measurable” criteria). For example, a firm experiencing potential environmental remediation liabilities should recognize such liabilities when it ascertains a reasonable value of the amount of such damages. SFAS No. 5 discusses this matter further.

4) A primary advantage of using a contra-accumulated depreciation—rather than as a direct reduction to the associated fixed asset account—includes keeping better track of the original cost of the acquired asset. Disclosing both the original and accumulated (depreciation) components of a fixed asset informs the financial statement reader of what part of such assets have “expired.” Moreover, directly reducing the “used” portion of fixed assets will eventually bring such assets (i.e., at the end of their depreciable lives—unless some salvage value exists) to a “zero value,” while these assets actually exist.

9-a. 1) The professor received his PhD from the University of Illinois, and he continued teaching there after he was finished with the program.

2) The general ledger does not balance. It must balance before we leave.

3) Did Robert say, “Can this item be classified as an asset?”

4) Susan’s investigation didn’t discover any fraud but there’s new evidence that might keep the investigation going.

5) Dear Mr. Smith,

9-b. 1) The auditor said, “We must have these work papers completed by tomorrow.”

2) When do we have to file our taxes?

3) Is the conference in Dallas or Austin, Texas?
Student Cases with Solutions to accompany *Accounting & Auditing Research: Tools & Strategies* (7th edition)

NOTE: In addition to the in-chapter and end-of-chapter exercises which serve as short cases you will find the following short cases arranged by course title that can also be utilized as short cases that require the student to access the authoritative literature to address the issue presented in the case. Other excellent sources of longer and more detailed cases include the Deloitte Trueblood cases (www.deloitte.com/more/DTF/cases_subj.htm), as well as the AICPA cases (www.aicpa.org).

A topical listing of the cases is presented with the case and solution following the listing.

**Topical Index of Student Cases**

**INTERMEDIATE ACCOUNTING Cases**

Case 1: Reporting acquisition and repayment transactions in the Statement of Cash Flows

Case 2: Recording a forfeited payment

Case 3: Revenue and expense recognition associated extended warranties

Case 4: Accounting for “due on demand” note payable

Case 5: Purchase of a controlling interest with a greenmail premium

Case 6: Revenue recognition in the construction industry

Case 7: Accrual and measurement of interest payments

Case 8: Recognition of an asset transfer when title has not yet been received

Case 9: Capitalization of interest and property taxes on a construction project

Case 10: Deferred compensation and life insurance policy recognition

Case 11: Reporting earnings per share balances for subsidiary companies

Case 12: Deferment of lease payments

Case 13: Disclosure of prior period adjustments in the statement of cash flows

Case 14: Measurement and recording of payments for sick days

Case 15: Comparative cash flow statements
Case 16: Social security benefits as assets
Case 17: Recording a stock dividend as a stock split
Case 18: Gain on a nonmonetary exchange

**ADVANCED ACCOUNTING Cases**
Case 1: Reporting of letters of guarantee notes payable
Case 2: Factors affecting minority interest control
Case 3: Profits and losses in the investment in foreign currencies
Case 4: Amortization of foreign currency transaction gains and losses
Case 5: Reflection of expensed computer programs on consolidated financial statements
Case 6: Classification of a proposed financial instrument as a hedge
Case 7: Disclosure of proceeds and payments from cash flow hedging activities
Case 8: Proper valuation of a “guaranteed” business combination

**GOVERNMENT AND NOT-FOR-PROFIT ACCOUNTING Cases**
Case 1: Recognition restricted or non-restricted assets that are promised but not received
Case 2: Affect of “permanent” reductions in the value of “promised” assets
Case 3: Disclosure and classification on a company’s Statement of cash Flows
Case 4: Disclosure of potential interest rate swings and commercial paper by a city
Case 5: Capital and operating leases between related parties
Case 6: Elimination of profits on intercompany sales
Case 7: Reporting of funds and potential obligations on bonds issued for third parties
Case 8: Disclosure of payments made to agents or brokers
Case 9: Accrual of vacation time of unestablished employees
AUDITING Cases
Case 1: Communication with predecessor auditors
Case 2: Scope limitations
Case 3: Outside services for inventory counts
Case 4: Supplementary disclosures
Case 5: Restating prior years’ financial statements
Case 6: Independence in a review or compilation engagement
Case 7: Qualified report and account classification
Case 8: Re-issuance of financial statements
Case 9: Communication with audit committees
Case 10: Accounting for assets held for sale

TAX Cases
Case 1: When should gross income be accrued?
Case 2: Stock purchased by an employee
Case 3: Income sourcing- international
Case 4: Business deductions
Case 5: Deduction for foreign travel
Case 6: Contingent liabilities

INTERMEDIATE ACCOUNTING Cases
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?

Case 1 Solution:
**Problem Identification:** How should a company report, if at all, cash and non-cash transactions owed to an entity’s financial subsidiary?

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

**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.

**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?

**Case 2 Solution:**

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

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

**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.

**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?

**Case 3 Solution:**

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

**Keywords:** Loss contingency; non-refundable