Accounting & Auditing Research:

Tools and Strategies

**8th 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.

**Student Cases with Solutions to accompany Accounting & Auditing Research: Tools & Strategies (8th edition)**

**NOTE: In addition to the end-of-chapter exercises which serve as short cases you will find the following 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 and cases provided by various accounting firms.**

**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: Accrual and measurement of interest payments

Case 7: Recognition of an asset transfer when title has not yet been received

Case 8: Capitalization of interest and property taxes on a construction project

Case 9: Deferred compensation and life insurance policy recognition

Case 10: Reporting earnings per share balances for subsidiary companies

Case 11: Deferment of lease payments

Case 12: Disclosure of prior period adjustments in the statement of cash flows

Case 13: Measurement and recording of payments for sick days

Case 14: Comparative cash flow statements

Case 15: Social security benefits as assets

Case 16: Recording a stock dividend as a stock split

Case 17: 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: Interim financial information

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

Case 11: Accompanying Informtion

**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?