Accounting & Auditing Research: Tools and Strategies

10th Edition

SOLUTIONS MANUAL

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CHAPTER 1

INTRODUCTION TO APPLIED PROFESSIONAL RESEARCH

<u>Discussion Questions</u>

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 rsults.

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 authortitaive 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 tshe fous of Chapter 4. This database also includes the authoritative stnadards of the AICPA. GAO and PCAOB standars are suditing standards, not accounting standards.

26. Qualitiative analytics focuses on non-quantitiative data such as videos, pictures, or an enity’s e-mails. Wheras quantiative analysis focuses on the analysis of numberical data suchas 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 stdandards 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- ateh personnel Managaement Element of a Firm’s QC Conpetencies.

2. The IASB is the independent, accounting standard setting body that issues international financial reporting standards (IFRS) which are discussed in Chapter 5.

3. Standards may vary due to new issued standards. Recent IAASB standards listed on 1/10/2020 include:
   ISA 315-Identifying & Assessing Risks of Material Misstatements.
   ISA 540-Auditing Accounting Estimates & Related Disclosures.

4. One can filter by topic area and therefore various publications will be listed.

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 memos.

16. In Bloom's Revised Taxonomy, Understanding includes "explaining ideas or concepts", interpreting, summarizing, paraphrasing, classifying, or explaining. Evaluating includes "Justifying decision or course of action" checking, hypothesizing, critiquing, experimenting, judging.

Exercises:

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

	House 1	House 2	House 3	House 4	House 5
Color	Yellow	Blue	Red	White	Green
Country	America	Russia	England	Spain	Japan
Sport	Football	Table Tennis	Hockey	Basketball	Baseball
Drink	Water	Tea	Milk	Orange Juice	Coffee
Pet	Fox	Horse	Hamster	Dog	Monkey

2. Allison is the eldest.
   A= Allison, M= Mary, J= Jennifer, X=eldest
   If M = 1/2 X, J= A +M +1/2 X

   If A is eldest: A=X, J= X =1/2 X =3/2 X and Jennefer receives the highest points, and Mary as youngest receives the least points.

   If J is the eldest: J=X, J=A +1/2 X, A= 1/2 X, Allison and Mary receive the same number of points. However, the youngest receives the least points, so J cannot be the eldest.

3. 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 (ASC 210-45-3).

4. 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 ASC 450-20-25-1—probable and the amount can be reasonably estimated.

5. 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'"?

6. 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.

7. 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.

8. 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.

9. 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.

10. This question involves critical thinking that will vary between students and therefore does not have a right answer. Keys issues has future value and owned by the entity.

11. Some potential answers to the given questions include:

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.

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.

12. 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.

13. 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 <u>both</u> 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.

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

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

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

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

e) Dear Mr. Smith,

15. a) The auditor said, “We must have these work papers completed by tomorrow.”

b)When do we have to file our taxes?

c) Is the conference in Dallas or Austin, Texas?

CHAPTER 3

THE ENVIRONMENT OF ACCOUNTING RESEARCH

Discussion Questions

1. The development of accounting standards is influenced by such environmental considerations as the requirements of federal, state, and local government, and other regulatory bodies; influence of various tax laws on the financial reporting process; practices or problems of certain specialized industries (such as the motion picture or the oil and gas industries); inconsistencies in practice; disagreements among accountants, business executives, and others as to the objectives of financial statements; and influence of professional organizations.

2. A primary reason for the establishment of accounting standards appears to be in response to the increasing needs of various financial statement users--including investors, lenders, and governmental entities; the increasing complexity of business enterprises and their underlying economic events and accounting transactions; and the increasing requests of government agencies, legislative bodies, and professional organizations to respond to this demand.

3. The SEC divisions include: Corporation Finance, Enforcement, Investment Management Trading and Markets, and Economic Risk and Analysis.

4.The responsibilities of the Division of Corporation Finance include reviewing financial statement disclosures (e.g., registration statements, annual and quarterly filings, annual reports, and proxy materials) of all public companies at least once every three years; providing administrative interpretations of various securities acts as well as recommending regulations; and providing guidance to current and prospective registrants.

5. The two actions that Enforcement takes when authorized by the Commission are: (1) files a civil action in federal court seeking a remedy or sanction or (2) brings administrative actions such as cease and desist orders.

6. The FASB uses "due process" in developing its Standards, including identifying the problem or issue and considering legal or SEC pressures; deciding whether to consider the issue; establishing a task force to study the problem; having its research staff investigate the issues; issuing a discussion memo to interested parties; holding public hearings and request written comments on the issue; analyzing the results of the investigation, mail and hearings; if action is appropriate, issuing an exposure draft (a preliminary ASU); requesting additional comments on the exposure draft and holding further public hearings; after analyzing the public response, issuing a final ASU.

7. The FASB's conceptual framework project is a long-term project that should help describe concepts and relationships that underlie financial accounting standards and address such issues as the following: the elements of financial statements and their recognition, measurement, and display; capital maintenance; unit of measure criteria for distinguishing information to be included in financial statements from that which should be provided by other means of financial reporting; and criteria to evaluate and select accounting information (qualitative characteristics). This project can help practitioners develop theoretical justification for resolving issues that contain no authoritative citations.

8. Statements of Financial Accounting Concepts (SFAC) are not authoritative because FASB did not use full due process in the original project.

9. Some authoritative publications of the AICPA include: ARBs and APB Opinions (and non-authoritative Statements of Position and Issues Papers).

10. If content is within the Codification, it is authoritative.

11. A typical Accounting Standards Update (ASU) will contain the following; A summary of the key provisions leading to the update, specific amendments to the Codification along with implementation guidance, basis for the Board's decisions (including background information), and amendments to the XBRL Taxonomy.

12. No, ASU's are not authoritative in their own right. ASUs contain Codification update instructions and that becomes authoritative once incorporated into the Codification.

13. The groups/bodies that issue ASUs are the FASB, the EITF, and the PCC. The issuing groups is listed parenthetically after the title of the standard. See ASU 2020-01 below as an example.

Update 2020-01—Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)—Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 (a consensus of the FASB Emerging Issues Task Force)

The instructor could expand the question to ask how the ASUs are issued with a solution of: ASUs are issued in sequential order by the FASB, the EITF, and the PCC. Thus, they encompass FASB standards, emerging issue standards, and private company standards. ASU's are issued in the format of "year-sequential update number" (For example, 2017-2 is the second standard issued in 2017) and are labeled by the body creating the standard (FASB, EITF, or PCC).

14. The purpose of GASB is to set financial accounting and reporting standards for the public sector as the FASB does for all private entities. The public should have an interest in governmental financial reporting because of the large value of assets managed by governmental entities. The financial community can also be affected by financial crisis in municipal units, such as the infamous crisis in New York, Cleveland, and Orange County.

15. Generally Accepted Accounting Principles (GAAP) constitutes "a technical accounting term which encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time." GAAP also changes in response to changes in the business environment, and alternative principles for similar transactions may be considered equally acceptable.

16. A critical implication of authoritative support relative to GAAP for the researcher includes that he or she should seek to find the highest available level of support. Primary authoritative support should be reviewed first; however, if no primary sources are found, the researcher would then drop down and review any available secondary support.

17. In conducting efficient research, the researcher should begin by reviewing primary sources that have the highest level of authority in the GAAP hierarchy prior to July 1, 2009 and the FASB Accounting Standards Codification™ (The Codification) subsequent to July 1, 2009.

18. Promulgated accounting standards frequently impact economic behavior, since decision makers frequently engage in certain transactions in order to "report" better financial statements. For example, companies adopting the provisions of FASB ASC 740-10-35-4 (Changes in tax laws or rates) could "transfer" part of their Deferred Tax Liability from a liability on the balance sheet to revenue on the income statement, as income tax rates fall; the reverse would occur as income tax rates rise.

19. Primary authoritative support differs from secondary authoritative support in that the former one provides sufficient authoritative support for including a particular accounting principle within GAAP. However, secondary authoritative support includes sources that support inclusion within GAAP, but individually do not constitute authoritative support.

20. The formation of the GASB caused the following two governmental organizations to be added to the list of Financial Accounting Foundation sponsors: the Government Finance Officers Association (GFOA) and the National Association of State Auditors, Treasurers, and Controllers.

21. Answers will vary. Rules-bases accounting provides specific rules or "bright-lines" for the accountant to follow while preparing financial statements. Principles based accounting does not provide these specific rules, thereby relying on professional judgment. An advantage to having rules is that there will be no question as to how to apply or interpret the standard. The disadvantage to having rules for all standards is that the volumes of literature are ever expanding and when standard setters leave anything open to interpretation, they are inundated with questions on how to apply the standard. Another disadvantage to "rules" is that not every company fits a certain mold. With that in mind, companies not fitting the rule must as for an exception or another application to be permitted.

22. FASB is addressing the "standards overload" issue by implementing a framework that emphasizes issuing standards that focus more on objectives than detailed rules. In addition, another project aims at improving the quality of the cost-benefit analysis performed on proposed standards, reducing the costs of new standards without decreasing the benefits. Overall, the FASB's goal is to make accounting standards that are easier to understand and apply.

23. The Private Company Council (PCC). It was created in 2012 to recommend guidance for private business entities.

24. PCC Decision-Making Framework: Framework identified five areas of difference between private and public entities:

a. number of primary users and their access to management
b. primary user investment strategies
c. ownership and capital structure
d. accounting resources
e. new financial guidance education

25. The seven FASB board members are elected by the FAF. They serve 5 year terms and are eligible for one additional 5-year term.

Practice Exercises on Standard Setters

1. The eight elements of reasoning for this question would include:

a. Purpose—the purpose is to respond to the client's request for information.
b. Issue—the issue is the proper accounting for R&D according to U.S. GAAP and International Accounting Standards.
c. Information—the information sources one would utilize are U.S. authoritative literature and International Accounting Standards.
d. Concepts—the concept would include the capitalization or expensing of R&D.
e. Assumptions—the assumptions would be that in order to capitalize R&D there exists future economic benefits.
f. Interpretations or Inferences—the interpretation is that R&D costs have future economic benefit in order for Daimler to capitalize such costs. Also, one must

conclude whether U.S. GAAP or International Accounting Standards are more appropriate if there exists a conflict.

g. Implications or consequences—if R&D costs are not properly recorded, the financial statements are considered misleading.

h. Solution—the solution according to US GAAP—FASB No. 2—is to expense R&D costs.

2. As of 2/26/2020 the Board members were Russell G. Golden, James L. Kroeker, Christine Ann Botosan, Gary R. Buesser, Susan M. Cosper, Marsha L. Hunt,, Harold Schroeder.

3. This answer will change as new standards are issued. As of 02/26/2020 the FASB's three most recent issued exposure drafts were:

- **a.** 02/10/20 Proposed Accounting Standards Update—Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets

- **b.** 11/26/19 Proposed Accounting Standards Update—Codification Improvements

- **c.** 11/12/19 Proposed Accounting Standards Update—Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting

4. GASB's Concept Statements include (summaries will vary by student) :

- **a.** Concepts Statement No. 6 - Measurement of Elements of Financial Statements (Issued 03/14)

- **b.** Concepts Statement No. 5 - Service Efforts and Accomplishments Reporting—an amendment of GASB Concepts Statement No. 2 (Issued 11/08)

- **c.** Concepts Statement No. 4 - Elements of Financial Statements (Issued 06/07)

- **d.** Concepts Statement No. 3 - Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements (Issued 04/05)

- **e.** Concepts Statement No. 2 - Service Efforts and Accomplishments Reporting—as amended by GASB Concepts Statements No. 3 and 5 (Issued 11/08)

- **f.** Concepts Statement No. 2 - Service Efforts and Accomplishments Reporting (Issued 04/94)

- **g.** Concepts Statement No. 1 - Objectives of Financial Reporting (Issued 05/87)

5. This answer will change as new standards are issued. As of 02/26/2020, the GASB's two most recently issued exposure drafts were;

a. Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements: Notes to Financial Statements—an amendment of GASB Concepts Statement No. 3

b. Implementation Guidance Update—2020

6a. This answer will change as new standards are issued. As of 02/26/2020, the two most recently issued FASB Statements were:

a. Update 2020-02—Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842)—Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842) (SEC Update)

Update 2020-01—Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)—Clarifying the Interactions between Topic 321, Topic 323, and Topic 815 (a consensus of the FASB Emerging Issues Task Force)

6b. As of February 26, 2020, the following PCC ASUs have been issued:

a. Update 2016-03—Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (a consensus of the Private Company Council)
b. Update No. 2014-18—Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination (a consensus of the Private Company Council)
c. Update No. 2014-07—Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements (a consensus of the Private Company Council)
d. Update No. 2014-03—Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach (a consensus of the Private Company Council)
e. Update No. 2014-02—Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill (a consensus of the Private Company Council)

7. The primary function of the Financial Accounting Standards Advisory Council (FASAC) is as follows:

Has advisory role in the process of establishing and improving financial accounting and reporting. FASAC works closely with the FASB in an advisory capacity to ensure that the views of its members are constantly and effectively communicated to the FASB. The FASAC is charged with responsibility of consulting with the FASB on major technical and non-technical issues and all other projects the FASB works on.

8. As of 02/26/2020

a. The two most recently issued SEC proposed rules include:

1. 34-88216 Feb. 14, 2020 Market Data Infrastructure and
2. BHCA-8 Jan. 30, 2020 Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

b. The Trading and Suspensions lists recent SEC trading suspensions.

9. As of 02/26/2020 the three most recently issued comment letters from the FEI to the FASB include:

a. CCR Responds to FASB's Invitation to Comment Identifiable Intangible Assets and Subsequent Accounting for Goodwill - Comment Letter | 10/29/2019

b. CCR Responds to the SEC's Proposed Modernization of Regulation S-K Items 101, 103, and 105- Comment Letter | 10/22/2019

c. CCR Responds to FASB's Proposed Rate Reform Relief -Comment Letter | 10/7/2019

10. As of 02/26/2020 the FinREC issued the following three most recent letters to the FASB:

a. October 19, 2019 - FinREC comment letter on FASB's July 31, 2019 Exposure Draft: Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)

b. October 3, 2019 comment letter on FASB Invitation to Comment (ITC), "Identifiable Intangible Assets and Subsequent Accounting for Goodwill."

c. July 15, 2019 - FinREC comment letter on FASB's May 14, 2019, Exposure Draft, Income Taxes (Topic 740)— Simplifying the Accounting for Income Taxes

11. As of 02/26/2020, three upcoming conferences of the IIA include:

a. General Audit Management Conference in Las Vegas, NV; March 16-18. 2020

b. IIA International Conference in Miami, FL; July 20-22, 2020

c. Governance, Risk and Control Conference in Austin, TX; August 17-19, 2020

CHAPTER 4

FINANCIAL ACCOUNTING RESEARCH TOOLS

Discussion Questions

1. The advantages of commercial databases, compared to free internet sources, include the providing of a more comprehensive document retrieval system, having better search capabilities, and making an effort to seek out reliable sources of information.

2. Some tools to help in using a database include the use of connector terms, database directories, different products within the database, and the use of full text searches or citation searches.

3. The typical search process in a database entails:

   a. Define the specific information needed.
   b. Determine the sources to search.
   c. Develop a search inquiry using keywords and sometimes connectors and limitations.
   d. Select how to view the search results, such as full text or just the citations.
   e. Print or download the relevant documents.

4. The challenges to accounting research include the issue of finding all relevant authoritative sources, and the fact that in certain cases there are no clear cut answers to the issue or problem. Professional judgment is required for problems that do not have apparent answers.

5. The four major topical FASB Codification topical guidance areas are: presentation, financial statement accounts, broad transactions, and industries.

6. The topical area "financial statements accounts" is further refined into subtopics: assets, liabilities, equity, revenues, and expenses.

7. An Original Pronouncements link can be found in "Pre-Codification Standards" located in the left navigation panel (Note: this link brings you outside of the Codification). Original standards can also be accessed from the FASB website.

8. The Codification is authoritative U.S. GAAP. For user convenience, it contains limited SEC content.

9. Secondary sources are used to help the researcher find an answer to a problem that has no primary authoritative support. Secondary sources need to be combined with other secondary sources to help support a conclusion.

10. a. Authoritative GAAP sources are found in the Codification and can originate from ASUs and prior to ASUs, from: the FASB (statements, interpretations, technical bulletins, staff implementations guides, SFAS 138 examples); Emerging Issues Task Force abstracts and Topic D; Derivative Implementation Group Issues; Accounting Principle Board opinions; Accounting Research Bulletins; accounting interpretations; items issued by the AICPA (Statements of Position, audit and accounting guides, practice bulletins, technical inquiry services).

b. Non-authoritative GAAP is any item not in the Codification and includes items such as notable industry practice, APB statements, AICPA issue papers, FASB concept statements, international accounting standards, textbooks, journal articles and monographs.

11. The SEC accounting authorities are different than GAAP because they follow the traditional legal hierarchy and are generally found under Title 17 of the United States Code. They are found at the SEC's website and in legal databases such as Westlaw and LexisNexis. They can also be found in the electronic code of Federal Regulations (eCFR).

12. The Codification has limited SEC authority for user convenience. The FASB, via the Codification, has no authority over SEC content.

13. EDGAR is different from other research tools because it uses an XBRL format that and viewer that allow the researcher to extract desirable information for analysis directly from filings without having to retype. This removes human error in data extraction and retyping.

14. Three common SEC forms include (answers can vary):

a. SEC 10-K: Public company annual report. Includes MD&A, select financial data, and audit opinions. Must be audited by independent external auditors.
b. SEC 8-K: Used by a public company to notify investors of material events. Must be filed within 5 days. Material events include change of executive management, entering/cancelling contracts, change of auditor, etc.
c. SEC 10Q: Quarterly financial statements. Need not be subject to an audit, but a review.

15. Three common SEC regulations include (answers can vary):

a. Reg S-K: Prescribes the requirements for information presented outside the financial statements required under Reg S-X
b. Reg Fair Disclosure: Requires that all publicly traded companies simultaneously disclose material information to all investors
c. Reg G: Disclosure requirements related to non-GAAP Financial measures

<u>Exercises</u>

1. Answers will vary slightly. The five research steps discussed in the chapter are: 1. define what information is needed 2. determine the sources to search 3. use appropriate search methods 4. view the results and 5. communicate the search results. 1. We know the information needed – due diligence review of a company. 2. Since that is related to auditing, use the AICPA database to locate the information. 3. perform a keyword search of "due diligence". 4. after reviewing the results 5. communicate in a memo to the client.

2. The five research steps are 1. Define the information needed – Natalie Churyk's suggestions for mastering the computerized CPA exam; 2 – the sources to search – the internet would be a viable option or a commercial database such as ABI Inform or EBSCO known for locating articles; 3- key word search using the author and key words from the topic would be appropriate; 4 – results from the internet – typing in "Natalie Churyk mastering the cpa exam" resulted in 257 hits. There appears to be two articles by Natalie Churyk – *Mastering the Technology*, and *The Computer-Based CPA Exam: Hints for Managing the Exam Technology*. The first is a quick synopsis on exam pitfalls while

the latter is an inclusive article on the computerized CPA exam. At this point, it may be helpful to circle back to the client to see exactly what the client is looking for (total exam, or just exam pitfalls). 5. Assuming the client is concerned with pitfalls communicate to the client in a memo the following regarding *Mastering the Technology* by Natalie T Churyk and Katrina L Mantzke: timing out at the front end, automatic shutdown, no going back to completed testlets, budgeting time for all testlets and simulations, the "Microsoft like" but not Microsoft software and how to use it, potential blind spots and other known exam problems.

3. The first three subtopics within the general topic of Presentation are: 205 – Presentation of Financial Statements, 210 – Balance Sheet, and 215 – Statement of Shareholders Equity.

4. One possible search strategy is to highlight Broad Transactions, 815-Derivtives and Hedging, 10 - Overall , 55 – Implementation Guidance and Illustrations.

5. **Cash**
   a. **GLOSSARY TERM USAGESEE TOPIC(S)210, 230, 305, 860, 942**
      Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made.
   b. SFAS 95

6. Answers will vary. Chosen - Film Production Interest Costs

   926-835-25-1 An entity shall account for interest costs related to the production of a film in accordance with Subtopic 835-20.

7. Answers may vary. Keywords – Not-for-profit revenue

   a. 958 Not-for-Profit Entities > 605 Revenue Recognition > 55 Implementation Guidance and Illustrations

      Example 19: Contribution to a Museum

      ... are not met. NFP I recognizes the revenue as the barriers are overcome, which is upon meeting the specific requirements as NFP I builds the new wing. The likelihood of meeting a milestone is not a consideration when assessing whether the contribution is deemed conditional.

b. 958 Not-for-Profit Entities > 605 Revenue Recognition > 55 Implementation Guidance and Illustrations

Example 20: Contribution to a Homeless Shelter

... advance liability and will then recognize $75,000 as donor-restricted revenue when at least 5,000 meals are served because the purpose of the grant is narrower than the overall purpose of NFP J. The likelihood of providing the meals is not a consideration when assessing whether the contribution is ...

c. 958 Not-for-Profit Entities > 605 Revenue Recognition > 55 Implementation Guidance and Illustrations

Example 16: Contribution to a Hospital

(P) June 16, 2018; (N) December 16, 2018 958-10-65-2 NFP DD determines that this contribution is not conditional because it does not include a right of return (or similar language) of the assets that have been transferred upfront. NFP DD concludes that it should recognize the revenue upon receipt ...

8. Use the topical categories in the left navigation panel to identify the capitalization of interest code section (topic, subtopic).

   835-20 Capitalization of interest

9. Capitalization of interest is required when getting an asset ready for its intended use.

   835-20-10-1 states that the objectives of capitalizing interest is to obtain a measure of acquisition cost that more closely reflects an entity's total investment in the asset and to charge a cost that relates to the acquisition of a resource that will benefit future periods against the revenues of the periods benefited.

   835-20-10-2 states that failure to capitalize interest cost associated with the acquisition of qualifying assets improperly reduces reported earnings during the period of acquisition and increases reported earnings in later periods.

10. Codification code references

    a. 310
    b. 505
    c. 460

d. 830
e. 720
f. 842
g. 440
h. 606
i. 815
j. 97x
k. 350

11. Find Use the Codification to find the guidance for (there are additional acceptable answers, the most common are listed below):

    a. Prepaid advertising 340-20; 340-10-05 (these are direct response advertising which is different than prepaid paid advertising in general); 210-10-45-1; 310-10-05-04
    a. Reclassification of long term debt. 470-10-45-14; 470-10-45-2, 470-10-45-12a or b, 470-10-45-13
    b. Accelerated depreciation 360-10-35-7 (only answer)
    c. Range of an estimated loss contingency 450-20-05-5; 450-20-30-1
    d. Reporting period 270-10; 270-10-05-1; 270-10-50-1
    e. Factoring of receivable with recourse 860-10-05-15; 860-20-55-24
       Students often cite the following but it is incorrect since this cites without recourse – 310-10-05-6

12. Use the Codification to find the guidance for:

a. What does it discuss? FASB Interpretation 36 discusses the accounting for exploration costs by oil and gas producing companies. Its rationale is that an unsuccessful company will end up capitalizing the costs.

b. How did you find the authority? Click on pre-codification standards which will link the user to the FAS website
c. The authority affects the gas and oil producing industry.
d. The major organizational parts of that authority are Status, Summary, Introduction, Interpretation, Effective Date and Transition, and the Appendix

13. Cost to be recognized as research and development 730-10-25-2 Five types of cost associated with R &D activities: (1) Material, Equipment, and Facilities; (2) Personnel; (3) Purchased intangible; (4) contract services; (5) Indirect costs.

    a. The salaries of the research staff designing new products can be classified as the personnel cost related with R&D activities thus can be expensed as R&D costs. 730-10-25-2
    b. The commissions paid to sales staff marketing new products is a selling expense, so it does not qualify. 730-10-15-4

14. Use the master glossary for the following question.
    a. Master glossary “C” - An existing condition, situation, or set of circumstances involving uncertainty as to possible gain (a gain contingency) or loss (a loss contingency) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.
    b. Master glossary “c”
    c. Contingent losses will be recorded when it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.
    d. 450-20-25

15. Post-retirement benefits other than pensions is located in 715-60. There are 11 sections from 00 status to 75 XBRL elements. Each section has multiple subsections.

16. Left click on Master Glossary in left navigation panel. Left click on the letter “P”. Scroll down to “postretirement benefits.” Hyperlink to 715-60-50, link to disclosure

    715-60-50-2 This Subsection provides guidance on disclosures regarding the effect of the Medicare subsidy. This Subsection also provides guidance on the disclosures about the effects of the subsidy for an employer that sponsors a postretirement health care benefit **plan** that provides prescription drug coverage but for which the employer has not yet been able to determine actuarial equivalency.

    715-60-50-3 In interim and annual financial statements for the first period in which an employer includes the effects of the subsidy in measuring the **accumulated postretirement benefit obligation** and the first period in which an employer includes the effects of the subsidy in measuring **net periodic postretirement benefit cost**, it shall disclose all of the following:

    - a. The reduction in the accumulated postretirement benefit obligation for the subsidy related to **benefits** attributed to past service.

    - b. The effect of the subsidy on the measurement of net periodic postretirement benefit cost for the current period. That effect includes any **amortization** of the actuarial gain in (a) of this paragraph as a component of the net amortization called for by paragraphs 715-60-35-29 through 35-30, the reduction in current period service cost due to the subsidy, and the resulting reduction in interest cost on the accumulated postretirement benefit obligation as a result of the subsidy.

    - c. Any other disclosures required by paragraph 715-20-50-1(r).

    715-60-50-4 For purposes of the disclosures required by paragraph 715-20-50-1(a) and 715-20-50-1(f), an employer shall disclose gross benefit payments (paid and expected, respectively), including prescription drug benefits, and separately the gross amount of the subsidy receipts (received and expected, respectively).

715-60-50-5 [Paragraph not used]

715-60-50-6 Until an employer is able to determine whether benefits provided by its plan are actuarially equivalent, it shall disclose both of the following in financial statements for interim or annual periods:

- a. The existence of the Medicare Prescription Drug, Improvement, and Modernization Act

- b. That measures of the accumulated postretirement benefit obligation or net periodic postretirement benefit cost do not reflect any amount associated with the subsidy because the employer is unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act.

17. Preferred stock has debt characteristics (a and b)

It should be accounted for as follows:

Mandatorily Redeemable Preferred Stock Not Accounted for as a Liability

810-10-40-2 Section 480-10-25 does not require mandatorily redeemable preferred stock to be accounted for as a liability under certain conditions. If such conditions apply and the mandatorily redeemable preferred stock is not accounted for as a liability, then the entity's acquisition of a subsidiary's mandatorily redeemable preferred stock shall be accounted for as a capital stock transaction. Accordingly, the consolidated entity would not recognize in its income statement any gain or loss from the acquisition of the subsidiary's preferred stock. In the consolidated financial statements, the dividends on a subsidiary's preferred stock, whether mandatorily redeemable or not, would be included in noncontrolling interest as a charge against income.

> > Mandatorily Redeemable Preferred Stock Accounted for as a Liability

810-10-40-2A Section 480-10-25 requires mandatorily redeemable preferred stock to be accounted for as a liability under certain conditions. If mandatorily redeemable preferred stock is accounted for as a liability, then any amounts paid or to be paid to holders of those contracts in excess of the initial measurement amount are reflected as interest cost and not as noncontrolling interest charge. Topic 860 specifies whether a liability has been extinguished and Subtopic 470-50 requires that the parent recognize a gain or loss upon extinguishment of the subsidiary's liability for mandatorily redeemable preferred shares for any difference between the carrying amount and the redemption amount.

480-10-S99-1 The following is the text of CFRR 211: Redeemable Preferred Stock.

- [.01 General : ASR 268: [CFRR 211, paragraph .01, sequence 1]]

[On July 27, 1979, the Commission amended Regulation S-X to modify the financial statement presentation of preferred stocks subject to mandatory redemption requirements or whose redemption is outside the control of the issuer.

The rules adopted do not impact reporting practices of registrants not having such securities outstanding. Registrants having such securities outstanding are required to present separately, in balance sheets, amounts applicable to the following three general classes of securities: (i) preferred stocks subject to mandatory redemption requirements or whose redemption is outside the control of the issuer; (ii) preferred stocks which are not redeemable or are redeemable solely at the option of the issuer; and (iii) common stocks. A general heading, "Stockholders' Equity," is not to be used and presentation of a combined total for equity securities, inclusive of redeemable preferred stocks, is prohibited. In addition, the rules require disclosure of redemption terms, five-year maturity data, and changes in redeemable preferred stocks in a separate note to the financial statements captioned "Redeemable Preferred Stocks." [CFRR 211, paragraph .01, sequence 2]]

[The Commission believes that redeemable preferred stocks are significantly different from conventional equity capital. Such securities have characteristics similar to debt and should, in the opinion of the Commission, be distinguished from permanent capital. The Commission believes that traditional financial reporting practices do not provide the most meaningful presentation of the financial obligations attached to these types of securities and that improvement in the financial statement presentation of redeemable preferred stocks is necessary. [CFRR 211, paragraph .01, sequence 5]]

18. (ASC) 440-10-50-1 requires disclosure of unused letters of credit. They are commitments and should not be reported as a liability in the financial statements.

19. SEC Forms

    a. 10-K: Annual report pursuant to Sections 13 & 15(d)

    b. **10-Q:** Quarterly report under Section 13 & 15(d)

    c. **11-K:** Annual report of employee stock purchase, savings & similar plans

    d. **18-K:** Annual Report for foreign governments & political subdivisions

    e. **20-F:** Annual & transition report of foreign private issuers

    f. **40-F:** Annual reports filed by Canadian issuers

    g. **8-K:** Current reporting filing

    h. **S-1:** General form of registration statement

    i. **6-K:** Current report of foreign issuer

    j. **17-H**: Risk assessment for broker and dealers

k. F3: Registration statement for securities of certain foreign private issuers

20. Rule 10b-5 discusses the issue of the "Employment of Manipulative and Deceptive Devises."

    SAB 99 provided the views of the SEC staff that exclusive reliance on certain quantitative benchmarks to assess materiality in preparing financial statements and performing audits of those financial statements is inappropriate; misstatements are not immaterial simply because they fall beneath a numerical threshold.

21. The Chief Accountant for the SEC is the principal adviser to the SEC Commission on accounting and auditing matters. The Office of the Chief Accountant also works closely with domestic and international private-sector accounting and auditing standards-setting bodies to monitor the application of accounting standards and financial disclosure requirements.

    Prepare your client to handle a SEC investigation through internal reviews, self-reporting, correcting problems, and cooperating with the SEC staff.

22. The seven methods to search with SEC's EDGAR include: company or fund name, ticker symbol, central index key, file number, state, country, or SIC.

23. This answer will vary. On the SEC website – the EDGAR System allows the user to hyperlink to the section desired whereas the report on the company website is static and one must scroll down to the section desired.

24. The SEC has issues with and asks for more information relating to: management's discussion, product performance, gross margin, fair value measurements, and segment information.

25. Go to the SEC website (www.sec.gov).
    a. 7 AAER's were issued as of 02/26/2020
    b. JPMorgan provided valuable positions within its firm to relatives and friends of key executives of its clients, prospective clients, and Asian government officials. This violates the FCPA. Many of their clients were also state-owned entities. JPMorgan was fined $72,000,000 in criminal fines. JPMorgan also paid a grand total of $130,591,405 in disgorgement fees.

26. Go to the Electronic Code of Federal Regulations (www.ecfr.gov).
    a. Part 210
    b According to Section 239.11, this form shall be used for first time registration under the Securities Act of 1933. As for the consolidated balance sheet item, according to Section 210.3-01, There shall be filed, for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years. If the registrant has been in existence for less than one fiscal year, there shall be filed an audited balance sheet as of a date within 135 days of the date of filing the registration statement.

27. Interim financial reporting

    a. Section 210.8-03 or Section 210.10-01

    b. 270-10-s99-1

28. LIFO reserves do need to be disclosed per Section 210.5-02 Balance Sheet 6 (04) c

29. Go to the Deloitte Foundation website (www.deloitte.com). Download a Trueblood Case involving a joint venture or partnership. Write a sentence summarizing the issue in the case. Use the Codification database to find the authorities providing the answer to the issue presented. Identify those authorities.

    a. Case 16-6 "Closely Associated Cars"

    The issue in this case is that a a joint venture (JV) was formed, and we need to determine if this JV is a variable interest entity (VIE), and who should consolidate JV. According to ASC 810-10-20, "Variable Interest Entity refers to a legal entity subject to consolidation according to the provisions of the Variable interest subsections of subtopic 810-10."

30. Accessing the *Journal of Accounting Education* V49, the two educational cases appearing in this volume are:

    a. Home Technology Innovations, Inc.: Transitioning to the new leasing standard "This case entails determining the expected financial statement impacts and related reporting requirements associated with the newly-promulgated leasing standard. The dataset includes financial statements, disclosures, and related supporting data for Home Technology Innovations, Inc. (a fictional, privately-held firm). You will determine financial statement effects of capitalizing existing operating lease obligations, evaluate the likelihood of exercising lease renewal options and calculate the impacts on lease capitalization calculations, research and prepare journal entries necessary to transition to the new leasing standards under both U.S. GAAP and IFRS, research and analyze the accounting for lease complexities, and apply broader business concepts in making recommendations. Instructors can select from combinations of case requirements so that the case can be used in financial accounting courses from the intermediate through the graduate level."
    b. A risk based approach to large datasets: Analysis of time series data for a large merchandising firm
    "This instructional case is designed to examine one approach to the analysis of large datasets using Excel software. The company annual revenue results spanned over 10 years of data for 879 functional units. Inventory counts for the company indicated higher inventory values than accounting records, running counter to the expected shrinkage, estimated at 3% of sales. As a member of the internal audit division, you are asked to examine the large database to identify stores where the

consistencies seemed largest and apply the COSO ERM risk framework to report risk. The impact and likelihood of two specific risks are examined and measured: financial statement overstatement and overpayment of commissions. Using actual internal audit work papers in place at a Fortune 500 company, the results are reported. Case questions are designed to help you think about the relationship between revenues in consecutive time periods, evaluate different forecasting models, and apply the forecasting models. Completing the risk matrix using results gives a hands-on approach to risk analysis. Completing the case questions also provides a basis for analysis that could be applied in other large datasets likely to be encountered in a continuous auditing environment."

Knowledge Busters

1. Topic: Revenue Recognition
   a. Only $1 million in additional sales should be recorded this year. The two remaining customer sale transactions should not be recorded as sales until next year. The SEC believed that the normal business practice for Medical Devices is to have a signed agreement and therefore persuasive evidence of a sale arrangement would not occur until Medical Devices receives the signed agreements. Since ASC 606 became effective, the SEC removed their guidance because it has been incorporated into the Codification ASC 606-10-25-2.
   "A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations."

2. Topic: Repurchase of Loans
   a. ASC 310-30-15 requires that if a seller repurchases the asset at a price greater than fair value, the seller should record the asset at its fair value and record a loss for the difference between the purchase price and the fair value.

3. Topic: Debt Classification
   a. ASC 470-10-45-11 states that current liabilities shall include any long-term debt that are or will be callable by the creditor either because the debtor's violation of a debt provision agreement which makes the debt callable or because the violation, if not cured within a specified grace period will make the debt callable. However, since the violation was cured in the second year and not called, the debt should be classified as long-term in year 2's financial statements. The debt should not be reclassified to long-term in year 1 based upon the set of facts.

4. Topic: Allowance Account
    a. ASC 310-10-35-7 states that "the conditions under which receivables exist usually involve some degree of uncertainty about their collectability, in which case a contingency exists…"
    b. ASC 450-20-25-2 would require the establishment of an allowance account if both of the following conditions exist:
        i. Information available prior to issuance of the financial statements indicates that it is probable that an asset has been impaired, and
        ii. The amount of the loss can be reasonably estimated
    c. If both of the aforementioned conditions are met, no allowance account is necessary.

5. Topic: Membership Dues
    a. Since the entity is a not-for-profit organization, ASC 958-605-25-2 requires that such dues be recognized as contributions and recorded as revenue when received as no services are exchanged for the dues. However, if services were received the dues would be recognized as revenue over the period of membership (ASC 958-605-25-1) This passage was transferred to ASC606 in 2018 but ASC 958-605-55-8 through 11 addresses this issue and these ASCs have not been superseded by ASC 606.

6. Topic: Stock Dividend
    a. ASC 260-10-55-12 requires that the computations of basic and diluted EPS be adjusted retroactively for all periods presented to reflect a change in capital structure due to the 3% stock dividend.

7. Topic: Inventory Valuation
    a. ASC 330-10-35-3 states that inventories should be valued the lower of cost or market with the excess of market disclosed. Furthermore, ASC 330-10-35-15 states that an exception to the lower of cost or market rule to record precious metals at market does not apply to National since the diamonds will be used in manufacturing process rather than being held for immediate sale. Therefore, the diamonds should be valued at cost in this case which is lower than market.

8. Topic: Insurance Contracts
    a. Since this is an insurance company, ASC 944-Fincial Services- Insurance is the appropriate reference. Specifically, 944-20-20 (Glossary) provides the definition for the two types of accounting that Matt is dealing with.

9. Topic: Current Assets
    a. ASC 210-10-45-4 states that the concept of current assets can exclude such items as follows: a) Cash and claims to cash that are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are

segregated for the liquidation of long-term debts. Therefore, the deposit for the purchase of the equipment should be classified as a noncurrent asset even though the purchase is within one year.

10. Topic: Treasury Stock
    a. ASC 505-30-30-4 states the following: “Transactions do arise, however, in which a reacquisition of an entity’s stock may take place at prices different from routine transactions in the open market. For example, to obtain the desired number of shares in a tender offer to all or most shareholders, the offer may need to be at a price in excess of the current market price. In addition, a block of shares representing a controlling interest will generally trade at a price in excess of market, and a large block of shares may trade at a price above or below the current market price depending on whether the buyer or seller initiates the transaction. An entity’s reacquisition of its shares in those circumstances is solely a treasury stock transaction properly accounted for at the purchase price of the treasury shares. Therefore, in the absence of the receipt of states or unstated consideration in addition to the capital stock, the entire purchase price shall be accounted for as the cost of treasury shares.”

11. Topic: Inventory
    a. ASC 330-10-30-1 states in part that, “As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location.” Therefore, warehousing costs would be considered a selling expense and not to be allocated to the inventory on hand.

12. Topic: Interest Capitalization
    a. ASC 835-20-30-3 states that “the amount capitalized in an accounting period shall be determined by applying the capitalization rate to the average amount of accumulated expenditures for the asset during the period.”
    b. Further, ASC 835-20-35-3 state that “The compounding of capitalized interest is conceptually consistent with the conclusion that interest on expenditures for the asset is a cost of acquiring the asset”.
    c. Therefore, the rate should be applied to the average of all the accumulated expenditures.

13. Topic: Research and Development Costs
    a. ASC 730-10-25 states that “R&D costs should be expensed when incurred”. There is no justification to capitalize the costs because the business is to be sold.

14. Topic: Cash Flow Statement
    a. ASC 230-10-15-3 states: A business entity or not-for-profit entity that provides a set of financial statements that reports both financial position and results of operations shall also provide a statement of cash flows for each period for which

results of operations are provided.

Therefore, if a balance sheet is presented, a statement of cash flows should be presented for both current and prior periods if income statements are presented for such periods.

15. Topic. Cash Flow Statement
    a. The amount that will be shown on the statement of cash flows is the two accounts with the positive balances. ASC 230-10-45-4, "The total amounts of cash and cash equivalents at the beginning and end of the period shall be the same amounts as similarly titled line items or subtotals shown in the statements of financial position . . ." The net change in overdrafts during the period is a financing activity.

16. Topic: Inventory
    a. The portion of the slow-moving inventory not reasonably expected to be realized in cash during the client's normal operating cycle should be classified as a long-term asset in the company's classified balance sheet. ASC 310-10-45-9 states that the term *current assets* is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

17. Topic: Data Analytics and Finance Charges
    a. Not an acceptable policy. FASB 310-20 states the interest (actuarial) method should be used to account for interest income. Also, ASC 310-2-35-2 requires that certain discount loans acquisition costs be deferred and treated as yield adjustments.

18. Topic: Consolidated versus Combined Financial Statements

ASC 810-10-05-6 permits combined financial statements in certain situations in which consolidated financial statements are not required. However, ASC 810-10-25-38 states that “an entity shall consolidate a variable interest entity if that entity has a variable interest (or combination of variable interests) that will absorb a majority of the variable interest entity’s expected losses, receive a majority of the variable interest entity’s expected residual returns, or both.” Furthermore, the starting point for the preparation of combined financial statements is two or more sets of financial statements that are prepared in accordance with GAAP; in the case of a primary beneficiary of a VIE, financial statements prepared in accordance with GAAP would be consolidated financial statements.

19. Topic: Dividend

The assets and related dividend income should be recorded at fair value. ASC 845-10-30-1 states that in general, accounting for nonmonetary transactions should be based on the fair values of the assets (or services) involved which is the same basis as that used in monetary transactions and that a nonmonetary asset received in a nonreciprocal transfer should be recorded at the fair value of the asset received. ASC 505, *Equity*, discusses accounting for stock dividends by the recipient; however, the scope of that pronouncement specifically excludes distributions of a different class of shares from that owned.

20. Topic: Foreign Currency Transaction Gains/Losses

No. According to FASB ASC glossary, foreign currency transactions are transactions whose terms are denominated in a currency other than the entity's functional currency. Foreign currency transactions arise when a reporting entity does any of the following:

a. Buys or sells on credit goods or services whose prices are denominated in foreign currency
b. Borrows or lends funds and the amounts payable or receivable are denominated in foreign currency
c. Is a party to an unperformed forward exchange contract
d. For other reasons, acquires or disposes of assets, or incurs or settles liabilities denominated in foreign currency.

ASC 830-20-05-2 - Foreign currency transactions may produce receivables or payables that are fixed in terms of the amount of foreign currency that will be received or paid.

ASC 830-20-35-1 - A change in exchange rates between the functional currency and the currency in which a transaction is denominated increases or decreases the expected amount of functional currency cash flows upon settlement of the transaction. That increase or decrease in expected functional currency cash flows is a foreign currency transaction gain or loss that generally shall be included in determining net income for the period in which the exchange rate changes.

Thus, even though the loan was obtained to construct the building, the transaction gains and losses are not part of the cost of the building, but are a result of the change in the exchange rate and are included in income each period in which the exchange rate fluctuates.

21. Topic: Industry – Real Estate

ASC 970-323 recommends that the equity method be used to account for investments in corporate or noncorporate real estate ventures. ASC 323-10-35- 19 through 22 state, in part: An investor's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by the equity method plus advances made by the investor. The investor ordinarily shall discontinue applying the equity method if the investment (and net advances) is reduced to zero and shall not provide for additional losses unless the investor has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee. An investor shall, however, provide for additional losses if the imminent return to profitable operations by an investee appears to be assured. For example, a material, nonrecurring loss of an isolated nature may reduce an investment below zero even though the underlying profitable operating pattern of an investee is unimpaired. If the investee subsequently reports net income, the investor shall resume applying the equity method only after its share of that net income equals the share of net losses not recognized during the period the equity method was suspended.

Accordingly, the investor should reflect its investment at a zero amount and disclose in a note to the financial statements the amount of its share of investee losses in excess of the zero amount.

22. Topic: SEC Reporting Requirements
    a. Form 8-K requires issuers that are subject to the reporting requirements of Section 13(a) and Section 15(d) of the Exchange Act to file required reports on Form 8-KL within four business days of a triggering event. The two triggering events in this case are the resignations of the two board members and the accounting firm. According to Item 4.01 "Changes in Registrant's Certifying Accountant" and Item 5.02 "Departure of Directors or Principal Officers", Clever is required to file a Form 8-K with the SEC.

23. Topic: Revenue Recognition

<u>SAB 116 rescinds prior SABS (104 and 101) on this topic (Persuasive evidence of an arrangement) and the guidance can now be found in ASC 606-10-25-2.</u>

<u>Document Review Simulation</u>

2. Complete the underlined information
    a. Original text: buildings; 40 years or less and equipment: 20 years or less
    b. Totaled: $2,035 million.

CHAPTER 5

THE ENVIRONMENT OF INTERNATIONAL RESEARCH

<u>Discussion Questions</u>

1. The predecessor committee to the IASB was the IASC. The standards are called IASs. As of February 27, 2020, it shows that 41 were issued (IAS 41) and there are only 25 still in use.

2. The process/procedure to establish an IASB standard is now aggregated into 4 major steps.
    a. Agenda consultation - Before a potential agenda item is set, the IASB receives input from working groups within the IASB, the Interpretations Committee, and the Advisory Committee. The IASB considers the potential agenda item's relevance, existing accounting guidance, the possibility of increased convergence, the potential quality of any proposed standard, and the resources needed to examine the potential agenda item.
    b. Research programme - The IASB plans the research project to determine whether to work with other accounting standard setters, such as forming working groups comprised of staff and/or members from the various standard-setting bodies. The IASB's working groups are chaired by the Director of Technical Activities or

Director of Research. Developing and publishing a discussion paper is not a mandatory stage, but the action is usually taken to obtain early feedback from constituents. If the discussion paper is omitted, the IASB will explain why. Typically, a discussion paper includes an examination of the topic, the alternative accounting treatments, the standard setters' views, and an invitation for comment. If another standard setter initiated the discussion paper, the IASB requires a simple majority vote before publication. If the IASB or one of its working groups initiated the research, the discussion paper is published because all IASB sessions are public. Analysis is performed on the comment letters received during the usual 120-day comment period, and the results are posted to the IASB Web site.

c. Standard-setting programme - Developing and publishing the exposure draft (ED) is mandatory and is based on IASB staff research, discussion paper comments, Advisory Council input, working groups, and other standard-setter input. Before the ED is issued for comment, a ballot takes place requiring approval by a supermajority (nine if the Board has 15 or fewer members, and 10 if the Board has 16 members) of IASB members. ED periods are usually 120 days or longer for major projects; if a matter is urgent, the ED period is 30 days. Once comments are received, they are summarized and posted to the IASB website. The IASB then decides whether to draft an IFRS or publish a second ED. If the IFRS is drafted, the IFRIC reviews the draft before it goes to the IASB for a vote. A version of the IFRS draft is also posted for paid subscribers. An IFRS is issued only after any outstanding issues are resolved and the IASB members have voted in favor of the standard.

d. Maintenance programme - The IASB and its staff periodically hold meetings with constituents with respect to implementation guidance and any unforeseen standard shortcomings. The IFRS Foundation promotes educational seminars and events to ensure proper application of the IFRS. Additionally, post-implementation review occurs a few years after a standard is in use to assess whether or not the standard is achieving its objective.

3. The IASB's Conceptual Framework (the Framework) establishes objectives and concepts for the development of accounting standards. The Board uses the Framework in the development of future standards. The Framework should also assist users and preparers/practitioners and researchers in applying and interpreting standards and financial statements. For instance, preparers and researchers may need to look to the Framework in the absence of a published standard, and auditors may want to ensure clients' financial statements are in compliance with the IFRS to form an opinion on those statements. However, occasionally, a conflict arises between the Framework and previously issued IASs or IFRS. In conflict situations, the standards override the Framework.

4. Although the Framework should be used to assist users, the standards override the Framework.

5. No, the IASB cannot enforce the use of its standards. Each country or organizations of countries can enforce use of IFRS. For instance, the EU requires use of IFRS in all member states and has set up various bodies (CESR and ESC) to help with consistency.

6. The Norwalk agreement was the first Memorandum of Understanding (MOU) between the IASB and FASB, whereby they agreed to work on both short- and long-term projects removing differences (convergence) between IFRS and U.S. GAAP and to continue coordinating activities.

7. The Work Plan was the process the SEC intended to follow in order to make an IFRS adoption determination. The final staff paper related to the work plan was issued in 2012.

8. Though the SEC has drafted a Work Plan to adopt IFRS, their final staff paper issued in 2012 does not address when, if, or how IFRS should be adopted in the US. Essentially, the decision is still open and the SEC did not make a solid decision on the Work Plan or IFRS adoption.

9. The CESR (no longer exists), ESMA and the EOC.

10. Although each IFRSs is equal, there is a hierarchy when choosing between standards;
    a. Apply specific IFRSs and consider relevant implementation guidance. If specific IFRSs do not apply, choose the relevant and reliable accounting policy from the listed sources in the following order:
    b. Apply other IFRSs that involve similar or related issues.
    c. Apply the IFRS Framework.
    d. Apply pronouncements of other standard-setting bodies that are consistent with the IFRS Framework.

11. The researcher should look to the hierarchy. If an answer cannot be found within IFRS a researcher could look to pronouncements of other stand-setting bodies as long as those pronouncements are consistent with IFRS.

12. All IFRS are authoritative; however, there exists a hierarchy within the standards, as described in DQ 10.

13. The main objectives of the IFRS Foundation are to develop a single set of global, high-quality standards; promote the use of those standards; consider its constituents (small to large and stable to emerging); and initiate convergence of IFRS with other national accounting standards.

14. Funding of the Foundation and the IASB is mostly voluntary and comes from organizations as well as various countries.

15. The SEC has expressed three conditions for accepting international accounting standards for all public companies:

a. IASB standards should include a core set of accounting pronouncements that constitute a comprehensive, generally accepted basis of accounting.
b. IASB standards must have high quality, result in comparability and transparency, and provide for full disclosure.
c. Rigorous interpretations and applications must exist for IASB standards.

Exercises

1. Answers will change as new projects are examined. As of February 27, 2020, three active projects include the following:
   a. 2019 Comprehensive Review of the IFRS for SMEs Standard
   b. Accounting Policies and Accounting Estimates (Amendments to IAS 8)
   c. Amendments to IFRS 17 Insurance Contracts

2. Very few modifications occurred. The EU carved out IAS 39. Saudi Arabia added disclosures.

3. Answers will change as time passes. As of February 27, 2020, two featured news pieces include:
   a. Getting to grips with IFRS 16? No time to waste.
   b. IFRS news archive

4. The working committees of the IOSCO are: the Executive Committee, the Growth and Emerging Markets Committee, the Affiliate Members Consultative Committee, the Policy Committees and Task Forces, Regional Committees, to name a few.

5. As of February 27, 2020 there are twenty-seven member states.

6. As of February 27, 2020, three active projects include and three completed projects include:
   a. Fees
   b. Role and Mindset Expected of Professional Accountants
   c. Rollout of Revised and Restructured Code
   d. Inducements
   e. Structure of the Code
   f. Safeguards and their Applicability Pertaining to Non-Assurance Services (NAS)

Using eIFRS

7.
   a. IFRS 15
   b. IFRS 7
   c. IFRS 2
   d. IAS 19
   e. IFRS 11, para 24 or IAS 28

f. IAS 41
g. IAS 33
h. IAS 23
i. IFRS 8
j. IAS 20

8. Enter e-IFRS, click on IFRS 1, introduction.
   a. IFRS 1 replaced SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*.
   b. Paragraph 4 of the Introduction requires an entity to comply with all IFRS effective at the end of its first reporting period by ensuring all assets and liabilities are in conformity. If not, they cannot be recognized.

9. As of February 27, 2020, twenty-three IFRICs have been issued, although not all are still active.

10. Answers will vary slightly depending upon which IAS/IFRS and IFRIC/SIC are chosen.
   a. .IFRS 7: Objective, Scope, Classes of financial instruments and level of disclosure, significance of financial instruments for financial position and performance, Nature and Extent of Risk, Effective date, withdrawal of IAS 30, Appendices, Approval of the Board, Basis for Conclusions, and Implementation Guidance.
   a. IFRIC 4: References, Background, Scope, Issues, Consensus, Effective Date, Transition, Appendix, Illustrative Examples, and Basis for conclusions.
   b. Yes, for the most part, both standards contain information about the standard, what it covers, how to apply it, the Board approval, and why the Board came to its decision.

11. e-IFRS research
   a. IFRIC 12
   b. SIC 7
   c. IFRS 8
   d. IAS 32 para 33; many student will cite IFRS 2 but that discusses using a company's shares for payment, not the general accounting for treasury shares
   e. IAS41

12. Impairment test for long-lived asset
   a. IAS 36
   b. Perused the list of standards until an "Impairment" standard was spotted.
   c. The accountant would take into account internal and external factors such as damage, obsolescence, adverse market conditions, and/or reduced cash flows. If the indicators are present, then the asset's recoverable amount needs to be calculated. If the recoverable amount is less than its carrying amount, impairment has occurred.

13. IAS 1 paragraphs 72-73 requires the company to have enacted the refinancing of short-term debt as of the balance sheet date in order to reclassify it as long-term.

14. No, IFRS avoids so called "bright lines" tests. IFRS 16 describes that classification depends upon the substance of the transaction, rather than the contract.

15. IFRS 15, para 20 suggests that some modifications are accounted for as separate contracts .

16. Use the glossary:
    a. Contingent liability definition - A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because: it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or the amount of the obligation cannot be measured with sufficient reliability.
    b. IAS 37 para 10

17. Materiality definition
    a. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.
    b. IAS 1 para 7, IAS 8 para 5, and glossary

18. According to IAS 38 paragraph 54, no intangible asset arising from the research phase of an internal project shall be recognized on the balance sheet. Once the project enters the development phase (paragraph 57), then you can recognize the cost on the balance sheet.

    An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:
    (a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.
    (b) its intention to complete the intangible asset and use or sell it.
    (c) its ability to use or sell the intangible asset.
    (d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
    (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
    (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Knowledge Busters

1. Topic: Asset Retirement Obligations
    a. ASC 410-20-25-5 states that upon initial recognition of a liability for an ARO, the entity shall capitalize an asset retirement cost by increasing the carrying amount of the related long-term asset.
    b. IAS #16 para. 18 states that an entity shall apply IAS #2- *Inventories* to the costs of obligations for dismantling, removing and restoring the site on which an item is located

2. Topic: First-Time Adopters of IFRS
    a. IFRS #1, *First-time Adoption of International Financial Reporting Standards,* sets forth the transitional requirements and exemptions available on the first-time adoption of IFRS. Paragraphs 6-12 provide details as to the recognition and measurement requirements. Specifically, the entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRS. Also, the entity shall use the same accounting policies in its opening IFRS statement of financial position and throughout tall periods presented in its first IFRS financial statements. (pars 6 & 7).

3. Topic: Business Acquisition
    a. According to IFRS 3 *Business Combinations* paragraph 18, the measurement principle states that the acquirer shall measure identifiable assets acquired and liabilities assumed at their acquisition date fair values (IFRS 3 para 37). The journal entry for this acquisition is as follows:

Accounts Receivable		20,000	
Building		200,000	
Goodwill		73,000	
	Accounts Payable		18,000
	Bonds Payable		125,000
	Cash		150,000

4. Topic: IFRS versus U.S. GAAP Comparison (secondary source/support) There are too many to list as summaries and this will change over time. Examples of secondary sources are PWC's, "IFRS and U.S. GAAP similarities and differences" https://www.pwc.com/us/en/cfodirect/publications/accounting-guides/ifrs-and-us-gaap-similarities-and-differences.html and EY's, U.S. GAAP versus IFRS" at https://www.ey.com/Publication/vwLUAssets/IFRSBasics_00901-181US_23February2018/$FILE/IFRSBasics_00901-181US_23February2018.pdf

5. Topic: Consolidation – Accounting Policies
Per IFRS 10 para. 19 - A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Thus, since the Parent reports in FIFO, the amount appearing in in the Consolidated financial statements should be the 4 FIFO amounts 6900 pounds (2000 + 1200 + 1500 + 2200).

CHAPTER 6
OTHER RESEARCH DATABASES AND TOOLS

Discussion Questions

1. The five steps for database research are:
   1. Identifying the issues or problems to research.
   2. Collecting evidence from data, authorities, and other sources.
   3. Evaluating the research results and various alternatives.
   4. Developing a conclusion, and
   5. Communicating a well-reasoned, documented memo.

2. Six major publishers of financial information should include he four largest global companies Pearson, RELX Group, Thomson Reuters, and Wolters Kluwer. Students should mention two other major publishers of financial information, such as Dun & Bradstreet, Wiley, or ProQuest.

3. CCH Accounting Research Manager includes complete authoritative U.S. accounting standards and international financial reporting standards, auditing standards, AICPA Audit and Accounting Guides for various industries, as well as AICPA technical practice aids, as well as insightful interpretations.

4. Research for governmental accounting depends on whether one is researching state and local government accounting (use GASB's governmental accounting standards in GARS Online) or federal government accounting (use FASAB's handbook).

5. Advantages of S&P's Capital IQ can include researching many private companies or acquring bond information.

6. Use Mergent Online when seeking industry comparisons, researching foreign companies, or when it's the best available financial research database.

7. Examine an analyst report in order to acquire a more comprehensive review of a company than financial ratio comparisons. Analysts closely examine other parts of the SEC filings on a company, such as financial statement footnotes and management discussion and analysis. They can analyze the implications of new developments in the company, such as a change in management or the release of a major new product.

8. The Audit Analytics database provides an online database useful for tracking and analyzing public company disclosures related to audit, compliance, corporate activities, and federal litigation.

9. Use the Factiva database when looking for business and financial information from the financial press, such as *The Wall Street Journal* and *The Financial Times*.

10. D&B Hoover's seeks to provide objective information, instead of relying on what a company's corporate staff might issue.

11. ABI/Inform Global includes international professional publications, academic journals, and trade magazines. Business Source Premier is used to access periodicals, peer-reviewed journals, trade generals, general business magazines, and other reports.

12. Conducting international business research is assisted by going to the website GlobalEDGE. Its Reference Desk has a Global Resource Directory which organizes research categories by Multi-Country, Statistical Data Sources, Rankings, Organizations, and Publications.

13. Opinions will differ on the best database to find information on Cargill. Students should provide reasoning to support their opinion.

14. The Guidestar database provides access to federal tax returns of almost 2,000,000 tax-exempt organizations.

15. Before hiring a local construction company to remodel one's house, one should acquire data about that company having problems from various databases. The most important database to check is PACER to determine what legal activities the company has had in either bankruptcy court or federal court. Additionally, a state court database is likely to exist, although it might provide only skeleton information. The state might also have a database related to complaints against contractors. Because settlements might involve withdrawing the complaint, this database is probably not as reliable as legal databases.

16. Financial ratios found in Nexis Uni database are found by selecting Companies and then Company Dossier. Search for the particular company of interest. A snapshot of the company appears, but more information, such as the financial ratios are accessible by selecting financial information, probably on the left side of the screen. Scroll down after the presentation of the financial statements to view the ratios.

17. Nexis Uni database provides only a small subset of information compared to the Lexis Advance database.

18. Advantages of using a new emerging legal database include using new technologies, such as various data analytic abilities in the database. Disadvantages include the possibility that an emerging database is discontinued because it is bought out or not as extensive as other databases.

EXERCISES

1. The FASAB calls its exposure drafts "documents for comments." In early 2020, one such document was on the deferral of the effective date on SFFAS 54 on Leases. Another document was on amendments to SFFAS 5, Accounting for Liabilities of the Federal Government.

2. A completed GASB project in 2020 was the Disclosure Framework in the Conceptual Framework. That information is listed under the tab for "Projects."

3. Accounting Standards Update (ASU) No. 2019-09, Insurance and ASU No. 2018- 12, Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts, which made targeted amendments to improve, simplify, and enhance the financial reporting requirements for long duration contracts issued by insurance entities. This is available on the FASB's website, as well as databases using FASB issuances.

4. Two statistical sources for business are from government agencies and trade associations.

5. Alexander & Baldwin operates primarily as a real estate company; however, its major operations also include Transportation and Agribusiness. The company is engaged in ocean freight transportation, property development and management in Hawaii and on the U.S. mainland, and producing sugar cane and coffee in Hawaii. Competitors found in a database will depend on the database used. Warning: the competitors selected by a database are usually not divided by different major lines of business.

6. Students should find a recent cyber fraud case. For example, in 2019, in a case released by the U.S. Attorney's Office in the Northern District of Georgia, 24 individuals were arrested because of a large-scale money laundering scheme that utilized multiple forms of cyber fraud such as romance fraud scams, retirement account scams and business email compromise schemes in order to steal over $30 million from those victimized. In 2018, the SEC issued a report that public companies should consider cyber threats when implementing internal accounting controls.

7. The Mergent Online database provides several useful financial ratios, such as the profitability ratios, liquidity ratios, ratio for debt management and asset management, as well as cash flow per share and book value per share data. Different subscriptions to Mergent Online may include more ratios. S&P Capital IQ provides many of the same financial ratios as Mergent Online and more detail ratios such as the growth over prior year. However, many find Mergent Online database is easier to read and it provides 15 years of financial ratios, whereas S&P Capital IQ only provides up to five years.

8. GASB Concept Statement No. 6 is entitled "measurement of elements of financial statements." It addresses both measurement approaches and measurement attributes. It was issued in March 2014. As of February 2020, no subsequent modification has occurred.

9. Interpretation 9 of Federal Financial Accounting Standards discusses "Cleanup Cost Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5 & SFFAS 6 (PDF)." Interpretation 9 was created in August 2019, to provide "clarification and guidance regarding cleanup cost liabilities..."

10. TDH Holdings, Inc. has major products primarily in pet foods. Its headquarters is located in China. The stock was volatile in 2019 because it received a delisting from NASDAQ because it was not complying with the listing rules.

11. In 2003, 19 year-old Elizabeth Holmes founded Theranos. The company operated as a blood-testing business. It was valued at $9 billion at that time as a privately held company not traded on any stock exchange. In 2015, The Wall Street Journal published an investigation of Theranos claiming the company wasn't using its own blood analysis machines to do many of the tests and not all lab test results were accurate. In 2016, Theranos laid off 340 employees and exited the business of running a laboratory. See

Mathew Herper, “The Decline and Fall of Elizabeth Holmes and Theranos,” Forbes, Oct. 8, 2016. In 2018, SEC charged Theranos with massive fraud. Her criminal trial is scheduled for summer of 2020.

12. IBM’s first footnote explains its significant accounting principles. The SEC website with its EDGAR database provides various financial reports and it required several clicks to get to the IBM’s 10-K. It is not always easy to find the notes to financial statements or a specific part of the financial statements due to its length as a single web page in the actual 10-K.

Advantages of commercial databases over the SEC’s EDGAR database are most noticeable in providing ratios and analysis. The SEC’s EDGAR database provides only the raw financial statements. However, disadvantages of commercial databases include that they often do not provide all of the information from the SEC filings by the company. For example, most commercial databases will not provide footnotes or other non-financial information contained in the 10K filing.

13. *Journal of Accountancy*, published by the AICPA, has many articles using the keyword "derivatives.” As of early 2020, the most recent example was written by Tysiac, K. (2017). “New FASB Standard Aims to Simplify Hedge Accounting,” *Journal of Accountancy.* The article explained that “Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, was created to:

- Better align accounting rules with a company’s risk management activities.
- Better reflect the economic results of hedging in the financial statements.
- Simplify hedge accounting treatment.”

14. Chevron’s annual report (10-K) filed with the SEC describes include some discussions relating to the company’s environmental liability, such as in the discussion of legal proceedings. Federal laws in the United States affecting environmental liability disclosure include the Clean Air Act Amendments of 1990 and others. Legal proceedings concerning any federal law shall be disclosed and described if they meet certain criteria such as if a governmental authority is party to a proceeding and it involves possible monetary sanctions. 17 CFR section 229.103 paragraph 5. A google search can also find a list of archived GAAP on the accounting for environmental liabilities. This includes SFAS No. 5, Accounting and Reporting for Loss Contingencies, SEC Staff Accounting Bulletin 92, regarding “accounting and disclosure obligations for contingent environmental liabilities.”

15. Uber, originally known as UberCab, was founded in 2009 as a black-car service. It became popular by offering affordably priced ride services and allowing users to request rides via their smartphone. Uber began service in 2010 in San Francisco. It operates in over 60 countries.

Uber's business model was based on the ideas of a tech company having drivers as independent contractors. However, lawsuits against Uber, particularly in California and Massachusetts called into question whether Uber drivers are really employees. Uber paid $100 million to settle the California and Massachusetts lawsuits in 2016.

Other legal issues arose as Uber's rapid expansion resulted in disregard for various state and local laws. Uber contractors have been charged with sexually assaulting customers. In 2017, Uber was sued by Alphabet (parent company of Google) for allegedly stealing self-driving technology.

16. Students might find several different answers of finding a recent article from the *Journal of Accountancy* that discusses "money laundering," such as Sarah Ovaska-Few's article in 2019 entitled "Keeping an eye out for money mules." Often, articles with the search term in the title may provide the most relevant articles, but one should check more recent articles with slightly different names to remain current with the topic.

17. Students may have various answers to examining an analyst report on Ford Motor Company, depending on the database and analyst report used. The answer should identify who wrote the report, outline the major contents of that analyst report, and identify where the student found the analyst report. For example, Emmanuel Rosner wrote an analyst report entitled "Ford: Making Sense of 4Q Results and 2020 Guidance."

18. Students are asked to identify the accounting and business databases at their university's particular library and to prepare a few PowerPoint slides to explain and illustrate one such database.

19. GAAP Concept Statement No. 5 is *Recognition and Measurement in Financial Statements of Business Enterprises.* The purpose of financial reporting is to communicate information to those outside an entity. It addresses criteria for an items' recognition in financial statements and or notes and the objective of financial reporting. The Concept Statement was last modified in 2008.

20. AICPA's *Audit and Accounting Manual* is found at HF5667. This book provides advice and examples for performing an audit. AICPA reference books are accessible in the AICPA's online subscription database or for purchase at the AICPA Store.

KNOWLEDGE BUSTERS

1. In 2019, Bristol-Myers Squibb acquired Celgene to create a biopharma company in a deal valued at $74 billion. Bristol Meyer's stock sank after the announcement, while the target stock rose in value.

2. S&P Capital IQ NetAdvantage can provide profitability ratios for Wells Fargo for the 5-year period from 2015, as shown in the chart below. In 2020, WF agreed to pay a $3 billion penalty to the SEC.

For the Fiscal Period Ending Dec. 31st of each year	2015	2016	2017	2018	2019
Return on Assets %	1.3%	1.2%	1.2%	1.2%	1.0%
Return on Equity %	12.3%	11.2%	11.0%	11.3%	10.4%
Return on Common Equity %	12.7%	11.7%	11.4%	11.6%	10.5%

Wells Fargo lost its reputation because some of its bankers had created millions of accounts in the names of its clients without their permission, due to sales pressure Wells Fargo's return on assets (ROA) and return on equity (ROE) have been decreasing since 2015, after the scandal. In 2020, Wells Fargo was fined $3 billion for the fake accounts.

3. General Electric has its worst performing year in 2017, of the three years analyzed from 2017-2019. In 2017, all of its profitability ratios held negative values versus in 2018 when only its return on equity and return on common equity were negative and in 2019 when only is return on common equity had a negative value of (0.4%). In terms of revenue growth, GE has actually experienced negative values in each of those fiscal years. With regards to overall financial health, the company has consistently maintained a total asset turnover of 0.3 for the last 3 years and has had a current ratio between 1.9-2.3, indicating that they are well enabled to cover their current liabilities utilizing their current assets. The company is highly leveraged by debt and has continued to increase this leverage. In 2017, the company's debt to equity ratio was 175.0% which increased to 314.9% by the end of 2019.

4. In 2019, the chair of GE's audit committee was Leslie F. Seidman. She was a FASB board member. Harry M. Markopolos, a former securities industry executive and a forensic accounting and financial fraud investigator, released a 175-page whistleblower report which accused GE of nearly $40 billion in accounting fraud tied to its insurance business. Previously, Makapolis helped expose the $64 billion ponzi scheme by Bernie Madoff.

5. As of early 2020, GE was the eighth largest power company with revenue at $38.5 billion. Competitors provided by the students by depend on the database or website used. For example, students might identify three larger power companies, such as State Grid Power Corporation in China, Enel in Italy, and EDF in France.

6. The North American Industry Classification System (NAICS) Code for property and casualty insurance is 524126. after googling for NAICS codes and using the WebSite www.census.gov/eos/www/naics, the Code is found by drilling down on finance and insurance.

7. Students must access an overview of the Korean company Samsung's products and then explain the significance of its Galaxy Note 7 line of products. The Galaxy Note 7 was discontinued due to customer safety concerns regarding the device overheating and exploding. Customers were encouraged to backup their data, switch off their device, and replace the device. Samsung product information and information regarding Galaxy Note 7 is available on Samsung's website. Databases can then help find relevant articles on the problem.

8. State Farm Group insurance is a private company, owned by policyholders who purchase insurance. Therefore, there is minimal financial information available on the EDGAR database. State Farm is ranked as the largest Auto and Homeowners insurer in the United States. Students summarize key financial ratios and compare them with those provided on State Farm's website.

9. One can go to the SEC website page for Accounting and Auditing Enforcement Releases (AAER) and search for documents containing the term "revenue recognition" to find two recent Accounting and Auditing Enforcement Releases (AAER) that address revenue recognition, such as AAER No. 3860 from February 24, 2017 (discussing a CPA firm which failed to follow PCAOB or GAAS standards in conducting its audits).

10. The SEC brought a civil action against Samuel and Charles Wyly alleging various securities law violations. The Wyly brothers established a group of offshore trusts and subsidiaries to trade shares of public companies, of which a Wyly was on the board, and failed to disclose their ownership of the companies. The jury issued a verdict on 9 out of the 10 claims, including securities fraud under section 10(b) of the 1934 act and several other violations. Therefore, the Wyly brothers had to disgorge their trading profits connected with the violations.

11. The Blackstone Group's stock price in 2019 ranged from just under \$33 to in excess of \$64. Information on the Blackstone Group was more readily available than most private equity firms because this Limited Partnership is publicly traded on the NYSE as one of the largest private equity firms.

12. Using data analytics, auditors can examine larger external data sets much faster than previously. Recent advances have improved the interfaces between the client and auditor data systems and improved various interfaces that facilitate data extraction. Now during the risk assessment stage of an audit, data is analyzed for understanding processes and controls. Many analyses are applied more widely. For example, risks highlighted might enable auditors to drill down in further detail as part of an audit's substantive testing. See ICEAW, *Data Analytics for External Auditors: International Auditing Perspectives*, part of the International Auditing perspective series, 2016.

CHAPTER 7
TAX RESEARCH FOR COMPLIANCE AND TAX PLANNING

Discussion Questions

1. Three types of tax reforms made in the Taxpayer First Act of 2019 are establishing an IRS independent office of appeals, improve IRS service, and expand taxpayer rights in various areas.

2. Tax planning concepts include (1) changing to a more favorable tax jurisdiction, (2) avoiding or postponing income recognition, (3) controlling the character or classification of income, (4) spreading income among related taxpayers, (5) selecting investments with the tax consequences in mind, (6) changing the timing for tax purposes, and (7) maximizing specialized deductions or tax credits. Students were asked to provide five tax planning concepts.

3. The difference between tax evasion, tax avoidance, and abusive tax avoidance is the means used to minimize one's taxes. Tax evasion consists of illegal acts. Tax avoidance seeks to minimize taxes legally. "Abusive tax avoidance" represents attempts to intentionally misapply the tax laws. However, in Europe tax avoidance often carries a negative connotation,unlike in the United States.

4. Tax research goals vary depending on the type of tax research. Policy-oriented research has the objective of providing new information that will help policy-makers make appropriate tax law. Application oriented tax research addresses existing tax law, with the objective of determining its impact for a given factual situation.

5. Challenges in tax research include identifying the relevant facts, constructing the precise legal issues for those given facts, searching for relevant legal authorities, selecting the correct legal authorities, and applying the law properly for the particular set of facts.

6. Tax compliance engagements prepare tax returns. Usually these are closed-fact engagements because all the facts have already occurred. In tax litigation the facts have also already occurred. Lawyers handle a tax case in court.

6. One difference between a treasury regulation and a revenue ruling is whether the authority has general or specific application. Treasury regulations interpret and clarify the statutory law. Revenue rulings apply the law to a specific set of facts. Another difference is the strength of the authority. Treasury regulations are stronger authority than revenue rulings.

7. The term "precedent" for tax research means that the legal principle announced in a court case will apply to future cases.

8. In a non-acquiescence, the IRS will not follow a court's decision in other cases.

9. IRB is the weekly publication by the IRS that includes revenue rulings and revenue procedures. The CB (Cumulative Bulletin) is a semi-annual publication that reorganizes these sources based on the relevant Code section that the revenue ruling interpreted.

10. The IRS generates tax forms, notices, and private letter rulings, and other documents.

11. Advise the client to go to federal district court if the precedent in the Tax Court is adverse to the client.

12. To find relevant cases in Checkpoint, the best way is to use the annotations tab within a tax service. Annotations usually provide one sentence summaries of cases, organized by issue around a Code section. Using the citator is another way to find relevant cases, after first finding one case on point. Alternatively, some researchers will look at Explanations in a tax service, focusing on the footnote sources for the relevant explanations.

13. AFTR and USTC reprint all tax cases, except those from the Tax Court.

14. Tax Court regular decisions announce something new in the law, while Tax Court Memorandum decisions are merely applying existing law to a different set of facts.

15. The federal court system is diagrammed below:

United States Supreme Court (the highest level court)		
12 regional Circuit Courts of Appeal		Court of Appeals for the Federal Circuit
Tax Court	94 District Courts (includes 5 in territories)	Court of Federal Claims

16. The basic steps of tax research include:
- Identify and refine the tax problem;
- Locate relevant tax authorities;
- Apply the authorities;
- Arrive at a defensible solution; and
- Communicate the results to the taxpayer.

17. A memo includes sections on the facts, issues, conclusion, and analysis (which includes discussion of the law and its application, sometimes under separate sub-headings).

18. Answers will vary for three websites that one should regularly. One website is IRS' website which has tax forms and publications, information for different taxpayers, and tax statistics. Some might list another relevant governmental website, such as a state departments of taxation. Professional associations often provide helpful information, such as the American Institute of CPAs (AICPA). Large accounting firms and tax publishers or software providers usually provide some value. There are also some specialized directories, such Tax and Accounting Sites Directory which has links for tax topics, tax forms, and many other tax and accounting concerns.

19. The reasoning or analysis is sometimes divided into separate sections on discussion of the law and then its application. Discussion of the law should include briefly explaining relevant Code provisions, regulations, and cases. In the application each source discussed should get referenced as to exactly how it applies to the given set of facts. Thus, the application integrates the law and the facts, instead of leaving that work to the reader's interpretation.

20. Professional tax work is changing because of changes in technology. Especially as data analytics has become more common, technology has helped to improve accuracy of results and reduced errors. Tax accountants are usually now more involved in giving tax and business advice, as well as performing future tax planning.

EXERCISES

1. Primary research authorities in this problem are (b) Tax Court memorandum decisions, (c) Revenue Procedures, and (e) Temporary Treasury Regulations and. Secondary sources in the problem are the (a) tax services and (d) IRS publications. Although some publishers consider anything produced by the government as a primary source, such as IRS publications, the better answer is that if a document has no legal authority, then consider it as a secondary source.

2. Students identify the topic or general content of the following provisions:

a. §62(a)(2): Adjusted gross income defined is gross income less trade and business deductions, including those of employees.

b. §162(e)(4): Trade or business expenses are denied for the costs of influencing legislation

c. §262(b): No deduction for personal, living, and family expenses, including basic phone expenses.

d. §482: Allocation of income and deductions among taxpayers (transfer pricing)

e. §501(c)(7): Exempt organizations includes clubs for pleasure, recreation, and other nonprofitable purposes, where substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

f. §751(a)(flush language): Unrealized receivables and inventory items sold or exchanged in a partnership interest are not a capital asset.

g. §6702(a): Frivolous tax returns are subject to a civil penalty.

3. Students identify the content of each of the following Internal Revenue Code divisions:

a. Subtitle A – Income Taxes §§1-1563

b. Subtitle A, Chapter 2 – Tax on Self-Employment income §§1401-1403

c. Subtitle A, Chapter 1, Subchapter C – Corporate Distributions and Adjustments

(Corporate Tax) §§301-385

d. Subtitle A, Chapter 1, Subchapter K, part 1 – Tax treatment of Partners and Partnerships (Partnership Tax), determination of tax liability §§701-709

e. Subtitle A, Chapter 1, Subchapter S – Tax Treatment of S Corporations and their Shareholders §§1361-1379

f. Subtitle A, Chapter 6 – Consolidated Returns §§1501-1563

g. Subtitle D – Miscellaneous Excise Taxes §§4001-5000

4. Students list the major Code sections for the following topics
(best to use table of contents research method for large topics):

a. Estate taxes: Sections 2001-2210

b. Capital gains: Sections 1201-1298, 1(h)

c. Stock dividends: Section 306 is the primary section.
(One can find additional sections using the index approach, such as Sec. 243–247.)

d. Business energy credits: Section 48

e. Passive losses: Section 469

f. Depreciation: Sections 167 and 168

g. Substantial understatement penalty: Section 6662

5. Students list the topics of the following IRS Publications:

a. Pub 15: (Circular E), Employer's Tax Guide

b. Pub 225: Farmer's Tax Guide

c. Pub 504: Divorced or Separated Individuals

d. Pub 535: Business Expenses

e. Pub 901: U.S. Tax Treaties

f. Pub 925: Passive Activity and At-Risk Rules

g. Pub 946: How To Depreciate Property

6. Students identify the topics of the following federal tax forms:

a. 990: Return of Organization Exempt From Income Tax; helps describe the nature of the organization, their expenses and amount received.

b. 1040A: U.S. Individual Income Tax Return; helps to calculate your adjusted gross income and the amount of tax you owe or amount that will be refunded to you.

c. 1065: U.S. Return of Partnership Income; this return reports their income, gains and losses, deductions, credits, etc.

d. 1099-OID: Original Issue Discount; this is used to document long-term debt instruments that are issued for a price less than the stated redemption price at maturity.

e. 1120EZ - U.S Corporation Income Tax Return

f. Schedule SE: Self-Employment Tax; helps to determine the amount of tax if one works for yourself.

g. Form W-2: Wage and Tax Statement; filed for each employee for whom income, Social Security or Medicare tax was withheld and helps to identify total annual wages.

7. Students identify the topic of the following Treasury Regulations, Revenue Rulings, and Revenue Procedures:

a. 26 C.F.R. sec. 601.601(d)(2)(iii): The purpose of publishing revenue rulings and revenue procedures. Reg § 601.601.

b. Reg. § 301.6333-1: Production of books.

c. 26 CFR Part 514.5: Patent and copyright royalties and film rentals.

d. Treas. Reg. 1.482-7(b)(1)(iii): Methods to determine taxable income in connection with a cost sharing arrangement: Divisional interests

e. Temp. Reg. § 1.956-1T(e)(5): Shareholder's pro rata share of the average of the amounts of United States property held by a controlled foreign corporation: Exclusion for certain recourse obligations

f. Rev. Proc. 89–14, 1989–1 C.B. 814 - This revenue procedure supersedes Rev. Proc. 86-15, 1986-1 C.B. 544, and restates the objectives and standards for publication of revenue rulings and revenue procedures, interpreting code section 7805 – Rules and Regulations

g. Rev. Rul. 2015-25, 2015-49 I.R.B. 695 - Part I. Rulings and Decisions under the Internal Revenue Code of 1986.

8. a. Section 61(a)(4) provides that interest is part of gross income.
b. Section 166(d) defines nonbusiness debts.
c. Section 1222(7) defines "net long-term capital gains."
NOTE: Most Code sections have a letter as a subsection. However, the handful of sections currently existing thate were written before the 1954 Codification, such as section 1222 continue to lack subsections.
d. Section 121(a) excludes gain from sale of principal residence in many cases.

9. Students must access a tax research database and answer the following questions; then repeat the problem using a different tax research database and compare the ease of use of the database:

a. Although one would expect a keyword search of "active trade or business" to pull up regulations interpreting code section 162 on a trade or business, it actually pulls up regulations interpreting various other code sections, such as:
Reg. §1.195-1 Election to amortize start-up expenditures.
Prop. Reg. §1.1.298-2 Rules for certain corporations changing businesses.

b. When conducting a keyword search of "tuition credit" in the Internal Revenue Bulletin/Cumulative Bulletin, the exact phrase will not appear in the code any document. However, a search without the quotes will show the most recent Revenue Rulings, as of early 2020 as

1) Rev. Rul. 2010-27, 2010-45 IRB 620.
2) Rev. Rul. 76-167, 1976-1 CB 329.
3) Rev. Rul. 73-255, 1973-1 CB 54.

Given the limited relevance of these keyword search results to a likely problem, encourage students to try using alternative search approaches within the database.

10. "Reportable transactions are listed transactions, confidential transactions, transactions with contractual protection, loss transactions, and transactions of interest." Reg. § 1.6011-4(b). IRS Form 8886 is the "Reportable Transaction Disclosure Statement."

11. The U.S. Treasury Department estimates the four largest tax expenditures for 2020 are:

- Exclusion of employer contributions for medical insurance premiums and medical care ($3,104,400 million)
- Exclusion of net imputed rental income ($1,643,790 million)
- Defined contribution employer plans ($1,296,880 million)
- Capital gains (except agriculture, timber, iron ore, and coal) ($1,227,330 million)

12. A deduction for traveling expenses while away from home in the pursuit of a trade or business exists under Section 162(a)(2). This deduction includes amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances.

Section 274 has several subsections that disallow certain travel expenses. Subsection 274(c) disallows certain foreign travel expenses. Subsection 274(h) disallows certain foreign convention travel expenses. Section 274(m) provides additional limitations on travel expenses. Subsection 274(n) has a 50% limitation on the deduction for meals and entertainment, which also applies to travel expenses.

Note: Disallowance provisions are in Part IX (Items Not Deductible) – Sections 261–291. Students sometimes mistakenly identify Section 62(b)(2) as a disallowance provision, when it actually determines how much of a deduction qualifies as an "above the line " deduction in determining AGI.

13. Section 6662(b)(2) provides a penalty for a substantial understatement of income tax. The penalty applies if any part of the required income tax is attributable to a substantial understatement, as defined in Section 6662(d). The penalty is an amount equal to 20 percent of such understatement.

14. Section 105(a) includes in gross income amounts received by an employee through accident or health insurance for personal injuries or sickness to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer. Students must also describe the process by which

they found the answer.

15. a. Section 101 has 9 Regulations (including 2 Proposed Regulations); the last Regulation is Prop. Reg. § 1.101-8.
b. Section 183 has 6 Regulations (including one proposed and one reserved); the last Regulation is Reg. § 1.183-4.
c. Section 385 has 7 Regulations (including two proposed and 2 temporary); the last Regulation is Reg. § 1.385-4T.

16. Section 183 addresses activities not engaged in for profit. Reg. § 1.183-2 interprets the term "activity not engaged in for profit." It provides nine factors to consider in determining whether an activity was engaged in for profit:

(1) Manner in which the taxpayer carries on the activity;
(2) The expertise of the taxpayer or his advisors;
(3) The time and effort expended by the taxpayer in carrying on the activity;
(4) Expectation that assets used in activity may appreciate in value;
(5) The success of the taxpayer in carrying on other similar or dissimilar activities;
(6) The taxpayer's history of income or losses with respect to the activity;
(7) The amount of occasional profits, if any, which are earned;
(8) The financial status of the taxpayer;
(9) Elements of personal pleasure or recreation.

17. Reg. § 1.162-5(a).

18. Reg § 1.6038A-1 (General requirements and definitions) provides rules for foreign-owned U.S. corporations and foreign corporations engaged in a trade or business within the United States (reporting corporations)? IRS form 5472 is for a reporting corporation required to file a return that relates to reportable transactions with a related party.

19. Same-sex marriage was recognized in an estate tax case by the U.S. Supreme Court in *United States v. Windsor*, 570 U.S. 744, 133 S. Ct. 2675, 111 AFTR 2385 (2013). The Court ruled that the Defense of Marriage Act unconstitutionally violated the Fifth Amendment's Due Process Clause by denying equal protection to same-sex couples who were lawfully married in their state.

20. Rev. Rul. 2016-15, 2016-26 IRB 1060, delves into code section 108(c)(3)(A) to determine what is qualified real property for purposes of income from discharge of indebtedness. This revenue ruling was issued June 10, 2016.

21. Revenue Procedure 2016-11, 2016-2 IRB 274, provides inflation adjustments for various civil penalties. Relevant code sections include 6651, 6652, 6695, 6698, 6699, 6721, and 6722. The revenue procedure was dated 12/17/15. The IRS will apply the penalties, rather than having taxpayer self-report them, so finding relevant tax forms are not needed.

Rev. Proc. 2017-3, 2017-1 IRB 130, identifies issues on which the Internal Revenue Service (the "Service") will not issue letter rulings or determination letters. Relevant code sections include: 45, 48, 61, 79, 83, 101, 115, 117, 119, 121, 129, 141, 170, 216, 265, 302, 306, 351, 355, 368, 403, 414, 448, 451, 457A, 501, 507, 641, 664, 761, 1014, 1362, 1502, 2702, 3401, 6050P, 7701, and 9815. This revenue procedure was dated Dec. 29, 2016.

22. A Circuit Court of Appeals decision is precedent for taxpayers residing within that court's jurisdiction. Because the Tax Court must follow the relevant appellate court, the taxpayer within that circuit court of appeal should not go to Tax Court. Instead, the taxpayer must pay the amount in dispute and sue for a refund in district court. A district court's decision from another part of the country is not precedent. Thus, advise the tapayet to go to the U.S. Court of Federal Claims.

23. Advise the client that an aticle is not a source of legal authority, but it may provide some perspectives for the case. A revenue ruling is issued by the IRS to provide an interpretation of the tax law. However, a revenue ruling does not carry the same legal force as treasury regulations. The IRS may revoke or modify the revenue ruling by subsequent rulings or treasury regulations.

24. Rev. Rul. 2013-17, 2013-11 IRB 608, ruled that for federal tax purposes, the terms "spouse," "husband and wife," "husband," and "wife" include an individual married to a person of the same sex, if the individuals are lawfully married under state law, and the term "marriage" includes such a marriage between individuals of the same sex.

25. Three issues existed in *Brinks Gilson & Leone*, T.C. Memo 2016-20. First, whether taxpayer was liable for the accuracy related penalty under section 6662(b)(1) on the under payment of tax relared to deducting year end bonuses that were non-deductible dividends. Second, whether section 83(a) dealing with property for services supported taxpayer's position that all amounts paid to shareholder attorneys qualified as compensation for services. Third, whether under substance over form principles, stock held by shareholder attorneys qualified as debt, so that the year-end bonus portion non-deductible as compensation were deductible as interest.
The court held taxpayer was liable for the penalty because the taxpayer did not have substantial authority for deducting the year end bonuses. Section 83 did not apply. The court also held stock held by shareholder attorneys did not qualify as debt, but were nondeductible dividends by the corporation.

26. "Material advisor" is defined in section 6111(b)(1)(A). A list of reportable transactions is needed. "Reportable transactions are listed transactions, confidential transactions, transactions with contractual protection, loss transactions, and transactions of interest. " Reg. § 1.6011-4(b).

27. Students find an example of data analytics in tax. For example, "predictive analytics" in tax integrates data from different sources (such as enterprise resource planning or point of sales systems) to predict future tax consequences based on statistical relationships found in historical data.

28. a. Possibly remind students how to find tax materials for your state. A helpful website is www.taxsites.com. Foe example, a copy of Hawaii's state tax return is at www.state.hi.us/tax/2016/n11.pdf.
b. A copy of Publication 597—"Information on the United States–Canada Income Tax Treaty," is on the IRS' website is at www.irs.gov/pub/irs-pdf/p597.pdf.
c. Based on the joint committee of taxation hearings in early 2020, proposed legislation is likely to develop in various areas, such as expiring tax provisions and corporate tax liabilities.

29. Note because the problem involves a state tax case, Checkpoint is not the most helpful database to find the case. Students can google or use Nexis Uni to find information on the case.

Colorado attempted to address "use tax" non-compliance by enacting a state law that imposed notice and reporting obligations on retailers that did not collect a sales tax. *Direct Mktg. Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016). Plaintiff ("DMA") was a group of businesses and organizations that marketed products via catalogs, advertisements, broadcast media, and the Internet. DMA challenged Colorado's law as violating the federal Commerce Clause, arguing that it unconstitutionally discriminates against and unduly burdens interstate commerce. The district court permanently stopped enforcement of Colorado's reporting requirements. However, the Tenth Circuit reversed holding that the district court lacked jurisdiction.

KNOWLEDGE BUSTERS

1. None of the expenses paid by Minsu's family for his Disney Training Program, prior to his becoming a Rock Star, are deductible. They are nondeductible personal expenses. Sec. 262(a). "Expenses of taking special courses or training … in seeking employment … are not deductible." Reg. § 1.212-1(f).

2. Section 6707(b)(1) provides a $50,000 penalty for failure to furnish information regarding reportable transactions, except tht listed transactions incur a penalty the larger of of $200,000 or 50% of the gross income derived from the services related to the listed transaction. If the omission is intentional, the penalty percentage is increased to 75%. "Reportable transactions are listed transactions, confidential transactions, transactions with contractual protection, loss transactions, and transactions of interest." Reg. § 1.6011-4(b). IRS Form 8886 is the "Reportable Transaction Disclosure Statement."

3. Preliminary key issues include:
(1) Can a cardiologist deduct the loss from the sale of his personal residence when relocating
to a new business location?
(2) Is the reimbursement for the loss on selling one's house included in gross income?
(3) Does the tax consequences for the reimbursement depend upon whether one takes a deduction?

Refine each issue more precisely by adding within the issue the key terms and reference to the most relevant Code provision (section, subsection, paragraph – as much detail as possible).

4. Sally cannot deduct the cost of her tax courses as a business expenses while earning a law degree. Section 162(a) provides a deduction for trade or business expenses. An individual's educational expenses from a program of study which will lead one to qualify in a new trade or business are nondeductible business expenses. Reg. § 1.162-5(b)(3). The disallowance of the deduction applies even if the education maintains or improves skills required for employment or meets the express requirements of the individual's employer. Earning a law degree will enable Sally to qualify for a new trade or business, regardless of whether she wants to enter that trade or business.

5. Yes, it's possible to claim a $3,000 deduction. The loan extended to the roommates qualifies as a nonbusiness debt. Sec. 166(d). When the nonbusiness debt becomes worthless, the resulting loss is considered a short-term capital loss. Capital losses are deductible by $3,000 per tax year, beyond offsetting capital gains in the taxable year.

6. In *Ballard v. Comm.*, 544 U.S. 40 (2005), the main issue was whether the Tax Court must disclose its use of reports from special trial judges. The Supreme Court held the Tax Court's historic practice of not revealing such a report violated the Court's procedures. The Supreme Court reversed and remanded the case back to the Seventh Circuit Court of Appeals.

7. a. A Tax Court regular decision which discussed whether hair transplants are deductible medical expenses was *Mattes v. Commissioner*, 77 TC 650 (1981).
b. The Tax Court held the hair transplant operation was a specific medical treatment, so the cost of the hair transplants qualified as a deductible medical expense under Sec. 213(e).
c. Hair transplant is now regarded as cosmetic surgery and such cost does not qualify as a medical expense. "Medical care" does not include cosmetic surgery, unless the surgery is to correct a deformity arising from birth, an accident, or disfiguring disease. Section 213(d)(9)(A).

8. Revenue Ruling 2013-17, 2013-38 IRB 201, defined a married couple after same-sex marriage was recognized in an estate tax case by the U.S. Supreme Court. Essentially, terms that previously applied exclusively to persons of opposite sex will apply to individuals married to person of same sex if marriage is lawful under state law. However, Treas. Reg. 301.7701-18 now defines spouse, husband and wife, husband, wife, and marriage.

9. The following is a brief memo explaining the tax consequences of a football scholarship.

Tax File Memorandum
July 30, 2017

From: Student's Name
Subject: Athletic Scholarship

Facts: Best Friend received a full scholarship from the University of Colorado at Boulder for playing college football. The scholarship covered tuition, dorm room and meal costs there.

Issue: Whether a scholarship received for playing on a college sports team is excludable as a qualified scholarship under sec. 117(b)?

Conclusion: An athletic scholarship is excludable to the extent of other qualified scholarships.

Reasoning: A qualified scholarship is excluded. Sec. 117(a). The exclusion covers qualified tuition and related expenses for fees, books, supplies, and equipment. Sec. 117(b)(2). Gross income includes compensation for services. Sec. 61(a)(1). Amounts paid as compensation for services is not considered a scholarship. Reg. § 1.117-4. Athletic scholarships awarded by a university primarily to assist the recipients in pursuing their studies are excludable. Rev. Rul. 77-263, 1977-2 CB 47. The amounts received for the dorm room and meals are gross income. Reg. § 1.117-5(c)(1) flush language.

10. The following is a brief memo explaining the tax consequences of swapping services within the family.

Tax File Memorandum
January 30, 20XX
From: YYY
Subject: Personal services within the family

Facts: Older sister Sara agreed to tutor her younger sister in math for about a month. Older sister usually charges her clients $500 for similar services. Younger sister usually charges $100 for tax research services.

Issue: Whether services provided between siblings are excludable as gifts under sec. 102(a)?

Conclusion: The value of the services between family members are excludable as gifts.

Reasoning: Except as provided, gross income includes compensation for services. Sec. 61(a)(1). Gross income includes income realized in any form, including services. Reg. § 1.61-1(a). However, sec. 102(a) states that gross income does not include value of property acquired by gift. The Supreme Court defined as gift in *Commissioner v. Duberstein*, 363 U.S. 278 (1960), as essentially coming from true love and affection. The family context of the sisters suggests real love and affection for a gift excludable under sec. 102(a).

11. Sven should not recognize anything from the extinguishment of the debt. First, Section 108(a)(1) excludes the amount of the discharge of a qualified farmer indebtedness. Whereas, Myrtle recognizes a $20,000 gain from transferring her gardening property, based *James J. Gehl*, 102 T.C. 74 (1994), the excess of the fair market value of the property over its basis.

12. Students apply their knowledge of researching tax law, to finding authorities in other areas of the United States Code:

a. 15 U.S.C., chapter 2B, section 78j-1(b)(1) –**Required response to audit discoveries in the auditor's investigation and report to management.**
b. 26 U.S.C., subtitle f, chapter 73, section 7101 – **Bonds and their form**
c. 31 U.S.C., subtitle B, chapter X - **Financial Crimes Enforcement Network, Department of the Treasury**
c. Title 9, chapter 3, section 304 **- Recognition and enforcement of foreign arbitral decisions and awards; reciprocity**
d. Title 11, chapter 13 – **Adjustment of Debits of an Individual with Regular Income**
e. Title 18, chapter 31, section 664 - **Theft or embezzlement from employee benefit plan**
f. Title 31, chapter 95, section 9503 **– Government Pension Plan Protection: Reports about Government pension plans**

CHAPTER 8
ASSURANCE SERVICES AND AUDITING RESEARCH

Discussion Questions

1. An assurance service engagement entails independent professionals (i.e., usually CPAs or those working for CPA firms) working to improve the quality of information, or its content for decision-makers.

2. An attest engagement entails a professional service where a practitioner is engaged to issue or issues a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party. An audit would be an example of an attest engagement since the auditor is issuing a written audit report on the client's financial statements.

3. Besides performing financial statement audits, the CPA practitioner can perform attestation, review, and prospective financial information engagements.

4. Unlike auditing standards, attestation standards add assurance to information other that historical financial statements. Attestation standards are an extension to the auditing standards.

5. The guidelines used to encompass accounting and review services consist of the AICPA's Statements on Standards for Accounting and Review Services (SSARS).

6. Unlike auditing standards, which provide measures of the quality of performance, audit procedures refer to the steps the auditor should perform in the engagement. Furthermore, while auditing standards remain identical for all audits (e.g., maintaining the CPA's independence),

auditing procedures change, depending on the nature and type of entity under audit and the complexity of the engagement.

7. Statements on Auditing Standards serve as the primary authoritative support in conducting an audit which also supplement and interpret the Principles. Interpretations further explain the SASs.

8. The term "must" indicates an unconditional requirement which means that the auditor must comply with the standard. The term "should" means that the auditor is also required to comply with the standard, but in rare cases may depart if they document the justification for the departure.

9. Rules based strandards are very detailed and descriptive that often leads to a checklist mentality. Whereas principles based standards often require the use of prodfessional judgment that provides more latitude in applying professional judgement and procedures.

10. Compilation- A service that provides in the form of financial statements information that is the representation of management without any assurance on the staatements.
Review- A service of inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance on the statements.

11. The PCAOB stands for the Public Company Accounting Oversight Board that was created by the Sarbanes/Oxley Act of 2002 to establish auditing and related attestation, quality control, ethics, and independence standards to by used by registered public accounting firms.

12.The three categories of professional responsibilities include:
1) Unconditional responsibility
2) Presumptively manadatory responsibility
3) Responsibility to consider

13. The Single Audit Act incorporates the concept of an entity-wide financial and compliance "single audit," rather than various federal agencies conducting separate financial and compliance audits. The Act requires an annual audit of any state or local government unit that has received $100,000 or more in Federal financial assistance.

14. Primary auditing guidelines in the public sector include the General Accounting Office's "Yellow Book," the Office of Management and Budget's Single Audit Act, and the AICPA's Attestation Standards, GAAS, and applicable Audit Guides.

15 The importance of the Code of Professional Conduct is that it outlines a minimum, mandatory and enforceable level of conduct in performing audits.

16. The Conceptual Framework (Threats and Sageguards) is utilized when there is no specific guidance in the Code to address a particular issue. A member would be considered to be in

violation of a rule if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

17. The Accounting Principles Rule requires that the audior must determine that the financial statements are in accordance with GAAP in order to render an unqualified/unmodified audit opinion.

18. Accounting and auditing research helps practitioners comply with the Accounting Principles Rule of the AICPA's Code of Professional Conduct as a critical means of ascertaining if management has adhered to GAAP in the preparation of financial statements.

19. Professional judgment plays a critical role the accountant/auditor's daily activities,_since the provisions of the Accounting Principles Rule-1.320 allows the auditor to be associated with financial statements that depart significantly from GAAP only under "unusual circumstances." The standard requests auditors to exercise professional judgment in justifying the position that adherence to a promulgated principle would be regarded, generally by reasonable men, as producing a misleading result.

20. Professioanl skepticism is a mental attitude that includes a questioning mind set. The auditor should always be alert to various conditions that may indicate potential misstatements due to error or fraud, and gather and evaluate the evidence obtained.

21.The authoritative auditing literature that has general applicability includes Auditing Principles, SASs, Auditing Interpretations, AICPA Code of Professional Conduct, for non-public company audits, and the PCAOB Standards for audits of public companies.

22 Some guidelines available to help the accountant serve nonpublic clients include provision' of the U.S. Comptroller General's Standards for Audits of Governmental Organizations. Programs. Activities, and Functions, GAO's revised Government Auditing Standards and U.S. Single Audit Act.

23. The authoritative body that exists to develop international auditing standards is the International Auditing & Assurance Standards Board (IAASB).

Exercises

1. ISA 500 (redrafted) *Audit Evidence*
   ISA 505 (revised & redrafted) *External Confirmaations*

2. The eight elements of reasoning include the following:
   a. Purpose—the purpose is to respond to the request by the client.
   b. Issue—the issue before the practitioner is what type of service engagement this is, which will direct the report to issue.

c. Information—the information to review would entail the assurance services standards, and in particular the consulting literature.
d. Concepts—the main concept to consider is the idea of the reliability of electronic commerce activities.
e. Assumptions—if the client is following proper electronic commerce practices and has implemented proper controls, it can be assumed that its activities are reliable.
f. Interpretation or Inference—since this assurance service falls under the domain of consulting services, the practitioner would follow consulting standards in conducting the review and reporting on the reliability of the activities.
g. Implications or consequences—if activities are not reliable, the practitioner will so state in the report.
h. Solution—The report by the practitioner would either state that the client's electronic commerce activities are reliable, or not reliable, depending on his or her review.

3. AU-C Section 505-.06-.16 explains the use of the positive and negative confirmation forms.

4. Section 100 under Valuation Services describes the following exampes of valuation engagements: transactions for acquitions or mergers, litigation services, or planning oriented engagements.

5.The Standard provides general principles for engagements in the preparation of financial statements, compliation engagements, and requirements and guidance fo review engagements.

6. Varies depending upon the date researched.

7.Four types of PFP services include: Cash flow planning, Retirement planning, Investment planning, and Education planning.

8.A member can receive disciplinary action without a hearing in the following cases: A crime punishable by imprisonment, failure to file any income tax return, or preparing and filing a false tax return.

9.Type of Engagement: Attestation Engagement, Related standard- AT section 201-Agreed-Upon Procedures Engagement.

10.An adverse opinion is appropriate "when in the auditor's judgement the financial statements taken as a whole are not presented fairly in conformity with GAAP". Professional Standard Section: AU-C 705.09.

1. An adverse opinion is appropriate "when in the auditor's judgement the financial statements taken as a whole are not presented fairly in conformity with GAAP". Professional Standard Section: AU-C 705.09.
2.
   Various answers are acceptable due to date searched.

Knowledge Busters

Case 1-a.

. AU-C Section 930.29 provides the guidance on review interim financial information. The following is an example of a review report AU-C 930.A57:

AU-C Section 930.A57---A Review Report on Interim Financial Statements:

Independent Auditor's Review Report

Appropriate Addressee:

Report on the Financial Statements

We have reviewed the accompanying [describe **the** interim financial information or statements reviewed] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended.

Management's Responsibility

The Company's management is responsible for the preparation and fair presentation of the interim financial information in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

[Auditor's signature][Auditor's city and state][Date of the auditor's report]

1-b.. AU-C Section 600.A60 and Exhibit A provide information when part of the audit is conducted by other independent auditors (group audits) and provides the following example of appropriate reporting by the principal auditor indicating the division of responsibility when he makes reference to the audit of the other auditor follows:

Independent Auditor's Report

Appropriate Addressee:

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.2 Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

ln our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31,20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Auditor's signature][Auditor*s city and state][Date of the auditor's report]

Case 2: Paragraph .06 of AU-C section 200 states GAAS require the auditor to obtrain reasonable assurance about whether the financial statements are free of material misstatements. If substantially all of the entity’s evidence has been destroyed and the auditor is unable to complete aaudit procedures a disclaimer of opinion should be issued.

Data Analytics Cases:

Case 1: Utilizing a data analytics software like Tableau discussed in chapter 10 which is free to faculty and students, one would attempt to analyze PO names and address with employee names and addresses for matches. According to AU-C 560.02, the resolution of this issue appears to constitute a subsequent event which is evidence of a condition that existed at the balance sheet datae, but sicne no transaction in fact ocurred which involved the client, it is no necessary todisclose in the financial stteements.

Case 2: a) Paragraph 11 and A25 of AU-C Section 501, addresses the auditor's responsibility to obtain sufficient appropriate audit evidence regarding the condition, which includes identifying obsolete, damaged, or aging inventory. b) based on the auditing standards, the auditor needs to obtain sufficient audit evidence as to the extent of obsolete inventory. Using data analytics software like Tableau discussed in Chapter 10, the auditor could determine the usage rate of the various types of inventory. The usage rate can indicate the estimated future supply of the items needed which may indicate obsolete inventory.

CHAPTER 9
REFINING THE RESEARCH PROCESS

Answers to Discussion Questions

1. The focus of accounting, auditing, and tax research includes determining appropriate alternative principles, locating relevant authorities for those alternatives, and using professional judgment in applying the authorities and accounting principles for solving the problem.

2. The three part approach used to identify the precise problem or issue is as follows:
    1) Preliminary problem identification,
    2) Problem analysis, and
    3) Refined statement of the problem.

3. Two common ways to search a database to collect evidence are keyword search within the database and drill-down search through the table of contents. Merely using a google search to find relevant Web sites and other accounting or tax resources is not a comprehensive search.

4. Keywords are used to evaluate and collect evidence to locate relevant authorities. Sometimes, a diagram can help the researcher in conducting and documenting an efficient literature search. The researcher also can review a list of keywords identified from the statement of the problem for relevant citations, cross-references to other helpful terms (whether broader, narrower, or related terms) and examine these additional terms for potential citations.

5. To determine accounting alternatives one should brainstorm the alternatives and verify their reasonableness. It is often helpful to consult colleagues within the firm, particularly those with more professional experience.

6. The purpose of a research memorandum is to document and communicate the research and conclusions in a concise and clear way with all supporting reasoning.

7. The researcher should document the research process with the following information:
    a) A statement of the problem and relevant facts.
    b) References to legal and/or authoritative literature used, along with a brief explanation of the relevant parts of the law or authorities.
    c) A description of alternative procedures considered and the authoritative support for each alternative.

d) An explanation of why why the recommended principle or procedure was selected and other alternatives were not selected.

8. Some basic ways of remaining current with the authoritative literature are developing a checklist, preparing some summaries of new pronouncements, reading of periodicals, reviewing accounting newsletters, and absorbing news information on relevant websites.

9. Complexities in international practice raise more questions about whether laws are enforced and professional standards are similarly applied.

10. Skills needed for the CPA Exam include knowledge, application, and analysis skills, as well as communication skills and technological skills**.**

Answers to Exercises

1. Reg. S-K item 306 (17 CFR 229.306) explains that the audit committee must state whether the audit committee (1) has reviewed and discussed the audited financial statements with management; (2) has discussed with the independent auditors the required matters (update the reg. to AS 1301 – communications with audit committees); (3) has received the written disclosures and the letter from the independent accountants and has discussed with the independent accountant the independent accountant's independence; and (4) recommended to the Board of Directors to include the audited financial statements in the company's Annual Report on Form 10-K. See SEC Rel. 34-42266 (2000).

2. SEC Accounting and Auditing Enforcement Release No. 3029 (Aug. 4, 2009) discussed charging General Electric with accounting fraud.

3. A tax treaty exists between the United States and Japan with respect to taxes on income. The treaty was signed in 1971 and was modified in 2003.

4. FASB ASC 280-10-05-3 requires using a "management approach [to segment reporting] … based on the way that management organizes the segments within the public entity for making operating decisions and assessing performance. Segment reporting under international accounting is under IFRS 8 (a summary is provided at www.iasplus.com/en/standards/ifrs/ifrs8).

5. Australia has the Australian Accounting Standards Board, a government agency for setting accounting standards. The Australian Securities and Investments Commission (ASIC) provides supervisory oversight of auditors and public accounting firms.The Australian Taxation Office administers the country's tax system.

6. FASB's disclosure project is intended to make financial statement disclosures more effective, coordinated, and less redundant. The goal is to communicate the information that is most important to users of each entitys financial statements. As of mid-2017, the project is focused on fair value measurement, defined benefit plans, income taxes, inventory, and interim reporting.

EXERCISES on GE

7. Students describe the history of GE's insurance business. They provide at least two reliable sources with proper citations.

8. Three significant differences between GAAP and SAP (statutory accounting principles) are (1) target group; (2) main objective; and (3) emphasis on the balance sheet.

Target Group difference: While GAAP was developed with investors and creditors in mind, SAP was developed with regulators and insurance policyholders in mind. The three core concepts of SAP are conservatism, consistency, and recognition. Conservatism is described as protecting policyholders. (NAIC, 2014).

Main objective: While GAAP seeks to provide financial statement users with decision-useful information to assess financial performance, SAP seeks to protect policyholders by ensuring that the financial condition of insurance companies is regulated. Solvency regulation for SAP requires a statutory surplus is required (assets exceeding liabilities) to demonstrate sufficient reserves to cover issued policies. (NAIC, 2019).

Balance Sheet emphasis: While GAAP focuses more on the income statement, SAP focuses more on the balance sheet. This is because the financial condition of an insurer is usually examined at a point in time rather than over time, and solvency is determined by analyzing the balance sheet SAP, the timing of revenue and expense recognition is "mismatched" because of the over-riding concept of conservatism.

National Association of Insurance Commissioners (NAIC). (2019). **Statutory Accounting Principles**. Retrieved from https://content.naic.org/cipr_topics/topic_statutory_accounting_principles.htm

National Association of Insurance Commissioners (NAIC). (2014). **Financial Analysis Handbook** – 2013 Annual / 2014 Quarterly. Retrieved from https://www.naic.org/prod_serv/FAH-ZU-14.pdf

National Association of Insurance Commissioners (NAIC). (2007). **Health Reserves Guidance Manual.** Retrieved from https://www.naic.org/documents/prod_serv_supplementary_hrg_op.pdf

9. Students explain how reserves are calculated for a health insurance business. For example, the three main types of reserves that are calculated for health insurance businesses are claim, contract, and premium deficiency.

Claim reserves are "a measurement of a reporting entity's contractual obligation to pay benefits, as of a specified date" (NAIC, 2007). Claim reserves should be created when a future obligation to pay a claim is incurred. The case reserve method calculation can be done by subtracting the paid claim amount from the eventual claim amount, using historical trends of similar claims, or using an estimate developed by a claim examiner. This method is more practical for smaller lines of business.

Contract reserves are created when part of the premiums received for policies will be directed toward paying for claim costs in future years. This is usually the case for LTC insurance. Actuarial techniques and assumptions are employed to determine the reserve amount, which is based on the "net premium value". This value is determined by calculating the amount of the present value of future claim obligations that exceeds the present value of future premiums (NAIC, 2014).

Premium deficiency reserves are required when the current reserve amount is not enough to cover the future claim obligations. Variations exist between states on this calculation in several areas including the time period to use, contract assumptions, the level of claim reserves available in the time period being considered, and what constitutes a "block of business" that the reserve needs to be calculated for (NAIC, 2014).

10. Students find and summarize a recent analyst report on GE. For example, an analyst report acquired from NetAdvantage in early 2020 is Scarola, Colin. "Stock Report | General Electric Company." CFRA, S&P Global Market Intelligence. February 22, 2020.

11. In 2019, GE sold GE's biopharma business for over $20 billion. Additionally, GE sought to save over $5 billion from cutting pension benefits. GE also cut its dividend payments to shareholders.

12. Students summarize the most important information on GE's health care business for a potential investor to know in 2019. Although GE stopped selling new LTC policies after 2008, the company still had 274,000 policies in force. To cover the expected insurance claims (*i.e.*, liabilities) associated with these policies, GE expected to contribute about $14.5 billion additional capital over the next seven years to their long-term care statutory insurance claim reserves. In a 2019 report by accounting fraud investigator Harry Markopolos alleged GE was under-reserved by $29 billion.

13. The MD&A section of GE's 2018 10-K provides summary information about the financial performance of its operating segments. All eight of GE's operating segments were profitable except for the "Power" segment. GE's Capital segment has continuously incurred substantial losses since 2016.

14. In late 2017, GE announced its intention to sell over $20 billion of assets over the next year or two. In 2018, GE sold a healthcare technology unit to Veritas Capital for over $1 billion in cash. In 2019, GE sold its biopharma business to Danaher Corp for over $20 billion dollars. Additionally, it also sold approximately $3 billion shares in oilfield services provider Baker Hughes. GE also sold its aircraft-financing business to Apollo Global Management LLC for over $3 billion. The sales are expected to stabilize the balance sheet in the long term by reducing leverage, paying down more debt than previously anticipated, and strengthening the balance sheet.

15. GE's effective consolidated income tax rate for 2018 was (2.9)%, according to its 2018 10-K. GE explained that the change in tax rates from 2017 to 2018 was due to the passage of the Tax Cuts Act in 2017.

16. In 2019, GE stock performed well. GE's stock performance is explained by GE's actions to cut costs and sell assets, as well as the rising stock market that year. In March 2020, the Covid Pandemic led to a steep decline in the stock market and GE performance.

KNOWLEDGE BUSTERS

1. Issues:

1. Whether financial statement disclosures of two segments are needed when one industry has two businesses with different financial trends in order to avoid misleading financial statement users under IFRS 8?

2. Whether an annual write-down of goodwill and its impairment is necessary under IAS 36 for a foreign company's American subsidiary's acquisition of a company with continued losses?

Conclusions:

1. A write-down of goodwill of an acquired entity with continuous losses is required under both U.S. GAAP and IFRS.

2. The financial statement disclosure of only two industries when one industry has two businesses with different financial trends is misleading and needs revising.

Authorities on segment disclosure:

Segment disclosure reporting is required of public companies in their annual financial statements. IFRS 8.2. The objective of segment disclosure is to provide users of financial statements with information about the business's different types of business activities and various economic environments. IFRS 8.1. Operating segments earn revenues and expenses, have results regularly reviewed by management, and have discrete types of financial information. IFRS 8.5.

Recognize an operating segment if the revenue is 10 percent or more of the combined revenues or assets are 10 percent or more of the combined assets. IFRS 8.13. Disclosure of segment information must include nonfinancial general information such as how the entity identified its operating segments and the types of products and services from which each reportable segment derives its revenues. IFRS 8.22. Required financial information includes the reported segment profit or loss, segment assets, the basis of measurement. IFRS 8.21.

Authorities on goodwill:

Goodwill is an intangible asset that often arises from a business combination. It is a separate line item in the statement of financial position. Goodwill is not amortizable because it has an indefinite useful life.

Potential impairment of goodwill in each reporting unit requires annual testing. IAS 36.10. The impairment is generally measured by comparing the fair value to the recoverable amount. IAS 36.105. Impairment losses are first allocated to goodwill and then pro rata to other assets. They are recognized in the income statement. IAS 36.104. The segment from which the business arose must disclose the loss. IAS 36.129.

Application of Authorities:
Sony should report separate information about each operating segment that met any of the 10 percent quantitative thresholds. IFRS 8.13. Sony should disclose segmental information for Sony Music and Sony Pictures, providing information about their reported segment profit or loss. IFRS 8.21. Other information for Sony to report includes the types of products from which each reportable segment derives its revenues, any reconciliations needed of the total segment revenues, and interim period information. IFRS 8.22.

Because the amount assigned to goodwill acquired was significant in relation to the total cost of acquiring Sony Pictures, Sony must disclose the following information for goodwill in the notes to Sony Entertainment's financial statements: (1) the total amount of goodwill and the expected amount deductible for tax purposes and (2) the amount of goodwill by reportable segment. IAS 36.104.

2. **List of Relevant Authorities on Independence:**

17 CFR §210.2-01 (Reg. S-X, Rule 2-01)
PCAOB AS 1005.03 (AU-C §§ 220.13) and AS 2101 (AU-C § 311)
SEC's AAER-2859 (Aug. 5, 2008)
AICPA Code of Professional Conduct, *ET sec.* 1.200.001, 1.265.020, and 0.400.26

Issue:
Is the independence of an audit partner of a CPA firm impaired if the partner invests in a side business with a public company audit client under 17 CFR §210.2-01 (Reg. S-X) ?

Conclusion:
An auditor's independence is impaired if either the auditor invests in a side business with an audit client since the audit client has the ability to exercise significant influence over the side business or the auditor has a material joint closely held investment with an audit client.

Reasoning:
The SEC will not recognize an auditor as independent if the auditor cannot exercise objective and impartial judgment during an engagement. A qualified auditor must have independence from their audit clients in both fact and appearance. An auditor's independence is considered impaired if the auditor has a material investment in an entity over which the audit client has the ability to exercise significant influence. 17 CFR (Code of Federal Regulations) §210.2-01.

An accounting firm's independence includes its mental attitude and any covered person under PCAOB, AS § 1005.01 (cf. AICPA, AU-C §220.01). The auditor must be free from any obligation to or interest in the client, its management, or its owners so that the general public recognizes the auditor as independent. PCAOB, AS § 1005.03 (cf. AICPA, AU-C § 220.13). Auditor includes all engagement team members. PCAOB, AS § 2101, FN 2 (AICPA, AU-C § 300.05). PCAOB Rule 3520 states, "a registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period."

SEC Accounting and Auditing Enforcement Release #2859 concerned independence-impairing business relationships. Ernst & Young (E&Y) was ordered to pay disgorgement of $2.4 million plus interest due to an independence-impairing business relationship between E&Y and a member of the board of directors for three E&Y audit clients. They collaborated in creating audio CDs called "The Ernst & Young Thought Leaders Series." The SEC ordered two E&Y partners to cease and desist.

The AICPA's Code of Professional Conduct (Code) requires independence in the performance of professional services provided by its members. Code ET sec. 1.200.001. An auditor's independence is considered impaired if the auditor has a material joint closely held investment with the audit client. Code ET sec. 1.265.020. A "joint closely held investment" is defined as "an investment in an entity or a property by the *member* and *client* (or the client's officers or directors or any owner who has the ability to exercise *significant influence* over the *client*) that enables them to *control* the entity or property." Code ET sec. 0.400.26.

Similarly, according to AICPA Code ET Section 55 of the AICPA Professional Code of Conduct, auditors are required to "maintain objectivity and be free of conflicts of interest in discharging professional responsibilities."

Application of Relevant Authorities:

If the audit partner of a CPA firm holds an investment in a computer side business with a member of the board of directors of a public company of an audit client, his or her independence is considered impaired. In this situation, the audit client has significant influence over the investment, therefore, the auditor is not independent. 17 CFR §210.2-01 (Reg. S-X, Rule 2-01).

Even if the audit partner in question does not engage in direct audit services, if the firm has only two audit partners, then, 17 CFR §210.2-01(f)(11) [Reg. S-X, Rule 2-01(f)(11)] classifies the second partner as a covered person, as he may perform second partner review. A similar situation exists if the lead partner of the audit client practices in the same office as the audit partner. Therefore, the auditor in question may be a covered person. PCAOB, AS § 2101.

In addition, as a covered person the audit partner has a direct business relationship with client's director, it indicates that this direct business relationship impairs the independence of an auditor with respect to the audit client in pursuant to 17 CFR §210.2-01 [Reg. S-X, Rule 2-01(c)(3)].
An auditor must not have any obligation to or interest in its owners (including directors) so that the general public recognizes the auditor as independent. Because the audit partner has a business interest with the director of the audit client, who has the power to influence the audit client, the general public may perceive that this business relationship is not independent. PCAOB, AS § 1005.03.

The audit partner and the member of board of director's business relationship is similar to the business relationship described in AAER #2859. If the SEC finds that the joint investment in the computer side business is independence-impairing, then the audit partner must cease and desist from causing any future securities violations and lose the right to practice as an accountant before the SEC. It is also likely that the CPA firm will have to pay disgorgement and interest.

Investing in a business with a board member of an audit client causes the two parties to have a joint closely held investment. AICPA Code ET sec. 1.265.020. A joint closely held investment between the audit partner and the board member of the audit client impairs the audit firm's independence since the audit partner's CPA Firm is performing professional services for the board member's company. The investment in the computer business, a material joint closely held investment with the audit client, also impairs an auditor's independence.

As both the audit partner and the director invest in the computer business, they control the business when they engage in a joint closely held investment. AICPA Code ET sec. 0.400.26. This impairs the independence of the accounting firm as the covered member and the director held business and financial interest in the computer business.

3. Facts:

Midwest Realty classified its lease commitments as operating leases. The lease agreement was standard and not cancelable. The agreement required the lessee to make the monthly payments over 10 years and offered the lessee a five- year renewable option. Midwest Realty was bound by the lease agreements on all the offices.

Midwest Realty, Inc. has the obligation to make the lease payments on the vacant offices; Midwest Inc. will incur a loss because it has not generated any revenue on the remaining six vacant offices.The loss is contingent upon whether Midwest company can sublease the remaining six offices to others. Midwest's loss is reasonably estimated and it is possible.

Issue:

Whether lease payments for vacant operating leases are recognized as a loss in the current period or recorded as an expense in the year paid under ASC 842-20-25-8?

Conclusion:
Since Midwest Realty is confident that the remaining payment for the six leases will be made, under ASC 842-20-25-8, the remaining cost of an operating lease for which the right-of-use asset has not been impaired consists of the following: (a) the total lease payments (including those paid and those not yet paid), reflecting any adjustment to that total amount ; (b) the total initial direct costs attributable to the lease; (c) minus the periodic lease cost recognized in prior periods. There is no need to record a loss. Instead, Midwest Realty can continue recording the lease payments an expenses.

Authorities (<u>Keyword/ Citation Diagram</u>):

Leases	Operating leases	ASC 840-20-50-1
		ACS 842-20-35-4
Property	Impairment	

Lessees are required to recognize a right-of-use asset and a lease liability for all leases, including operating leases. ASC 842-20-50. With few exceptions, capitalize all leases. Comment: many real estate transactions that are not a sale under ASC 840 now qualify for sale and leaseback accounting under ASC 842.

Because Southern Realty is not making any changes to their lease payments as of this accounting period; they should not remeasure the lease liability and should not adjust the right-of-use asset that is their lease commitments on the six vacant properties. ASC 842-20-50.

Communicate the Results:

To: Calvin Brain, Controller
From: XYZ, CPAs
Date: XXX
RE: Loss from Rental Agreements

At your request, we examined the potential impact of subleasing six offices of Midwest Realty, Inc. (Midwest) to others. The specific issue concerns whether Midwest can currently recognize a loss from the rental commitments on the vacant offices.

Midwest has an enforceable obligation to make the lease payments on the vacant offices, and has not generated any revenues from them. If the offices are subleased out, the losses are reasonably estimated. The authoritative literature supports that the accrual of a loss for the vacant lease offices and the amount of the loss will be the minimum estimate of the potential loss.

4. Step 1 -- Identify the Problems

(1) Preliminary problem identification:
Were all related party transactions disclosed?
Whether related party transactions created internal control issues?

(2) Problem analysis:
Bubba Smith, the inventor who founded XCO is still the majority shareholder. Bubba Smith and his two daughters comprise the majority of senior management for XCO, a public company. Bubba Smith and his two daughters are on a seven member board of directors. Interest is not specified in the accounts receivable from Bubba and his two daughters.

(3) Redefined statement of the problems:
Whether management has performed a proper assessment of the required disclosure of related party transactions under ASC 850-10?
Whether management control over related parties was sufficient for internal control purposes under PCAOB AS 2201?

Step 2—Authoritative Literature
(1) Potential keywords for a search:
Related Parties, Internal Control, and Executive Compensation

(2) Locate and review the authoritative sources and literature

Keyword/ Citation Diagram

Keyword Reference Descriptions	Citation
Related Party Disclosures	ASC 850-10
Related Party Disclosures	IAS 24
Related Parties	PCAOB AS 2410
Audit of Internal Control Over Financial Reporting	PCAOB AS 2201
Executive Compensation	Reg. S-K, items 402 and 404
Debt instrument treated as stock	Reg. §1.385-3

A company must disclose related party transactions. ASC 850-10-05-1. Related parties include immediate family members and key management personnel are related to the entity. ASC 850-10-05-3.

Auditors must consider the risk of possible undisclosed related party relationships and transactions and as part of understanding internal control over financial reporting, auditor should understand company's process for identifying related parties. PCAOB AS 2410.04. Auditors must ask the audit committee and management (including the internal auditor, in-house legal counsel, chief compliance officer, and human resources director) about their knowledge of related parties and related party transactions. PCAOB AS 2410.

Disclosure of compensation arrangements is different in U.S. GAAP and IFRS standards. U.S. GAAP does not require disclosure in the notes to the financial statements of "compensation arrangements" and similar items. ASC 850-10-50-1 Whereas, IAS 24, Related Party Disclosures, requires disclosure in the notes to the financial statements of management compensation.

For U.S tax purposes, a taxpayer who fails to collect proper documentation, must treat the related-party debt as equity in its entirety, without further consideration of the instrument's characteristics. Even if the proper documentation exists, however, does not guarantee debt treatment because the existing facts and circumstances test or the recharacterization rule may still re-characterize the documented debt as equity. Reg. §1.385-3.

Remaining Steps
Bubba Smith and his two daughters are related parties to XCO. ASC 850-10-05-3. XCO should have disclosed the accounts receivable and any interest paid on the notes. ASC 850-10-50-1. Any interest might qualify as compensation that XCO must disclose. The lack of proper documentation on these related party debts should lead the IRS to take the position that the accounts receivables are equity. Reg. §1.385-3. The auditor should have considered the risk of possible undisclosed related party relationships and transactions and as part of understanding internal control over financial reporting. PCAOB AS 2410.04.

CHAPTER 10

Forensic Accounting Research

<u>Discussion Questions</u>

1. Forensic accounting standards are issued by the Forensic & Valuation services Executive committee.

2. Four examples of fraud engagements could include:
   - a. Locating evidence of vendor kickbacks.
   - b. Locating hidden assets.
   - c. Providing assistance to the audit team in investigating a potential fraud.
   - d. Consulting as to implementation of fraud prevention, deterrence, and detection programs.

3. Forensic accounting, also commonly referred to as "litigation support," generally means the use of accounting in a court of law.

4. Simply defined, fraud is an intentional deception. Black's Law Dictionary defines fraud as:

> "A generic term, embracing all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, it includes all surprise, trickery, cunning, dissembling, and any unfair way by which another is cheated."

Four examples would include; Mangement fraud, Employee fraud, vendor fraud, and insurance fraud.

5. Three components of the fraud triangle include:
   a. Perceived pressure.
   b. Perceived opportunity.
   c. Rationalization.

   Knowledge of the three elements provides the practitioner with an understanding of the different approaches that may be taken in the investigation.

6.A red flag, or risk factor, is a characteristic that provides a motivation or opportunity for fraud to occur, or an indication that fraud may have occurred.

7. Management fraud, or fraudulent financial reporting, refers to actions whereby management attempts to inflate reported earnings or other assets in order to deceive outsiders. Employee fraud, or misappropriation of assets, refers to illegal acts perpetrated by employees of a company.

8. Risk factors associated with management fraud include:

   a. Management's characteristics and influence over the control environment.
   b. Industry conditions.
   c. Operating characteristics and financial stability.

   Risk factors associated with employee fraud include:
   a. Susceptibility of assets to misappropriation.
   b. Controls.

9. The basic steps of a fraud examination include:
   a. Identify the issue/ plan the investigation.
   b. Gather the evidence/the investigation phase.
   c. Evaluate the evidence.
   d. Report findings to management/ legal counsel.

10. Two examples of a business/due diligence investigation include:
   a. Verifying information about an entity before entering into a joint venture.
   b. A background check on new corporate officer.

11. Three computerized tools utilized by the fraud examiner include:
   a. Data mining software.
   b. Public databases.
   c. Internet.

12. Data mining software, an outgrowth of expert systems, models a database for the purpose of determining patterns and relationships among the data. Whereas public databases are various public accessible databases that contain information of different types such as lawsuits, bankruptcies, tax liens, and property transactions. Many of these databases are useful in a fraud examination/investigation.

Exercises

1. Answers will vary depending upon the type of search conducted.

2. The characteristics of identity theft includes:
   a) Someone wrongfully obrtaining,
   b) another person's personal data,
   c) by deception,
   d) for economic gain.

Two examples to commit identify theft inclue:
   a) "Sholder surfing" watching you form a nearly location as you punch in your credit card number.
   b) "Dumpster diving" searching though you dumpster (garbage) for personal data.

3. Answers will vary depending upon the name of the company researched.

4. Answers will vary depending the various types of fraud identified.

5. Answers will vary as the student explains the factors in the Madoff Ponzi scheme.

6. Answer will vary depending on the Enforcement Release accessed.

7. a) Three qualifications for becoming a CFE in the U.S. include: Be an associate member; meet minimum academic and professional requirements; and be of high moral character.
   b) Three items in the ACFE's library include: the EthicsLine, FraudInfo Newsletter, and Fraud Prevention Resources.

8. Answers will vary depending on site selected.

Knowledge Busters

1. According to Statement on Standards for Forensic Services No. 1, Section 2, states that this statement does not apply to a member who performs forensic services as part of an attest (audit) engagement since including forensic procedures in an audit are not considered a forensic engagement.

2. According to Statement on Standards for Forensic Services No. 1, Section 9, states that a member engaged as an expert witness in a litigation engagement may not provide opinions pursuant to a contingent fee arrangement.