

EIGHTH EDITION

# Accounting & Auditing Research

Tools & Strategies

Thomas R. Weirich | Thomas C. Pearson | Natalie T. Churyk

WILEY



ACCOUNTING  
&  
AUDITING RESEARCH



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TOOLS & STRATEGIES

Eighth Edition

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# PREFACE

**D**ramatic changes continue to take place in the accounting and auditing environments, both in the United States and worldwide. Developing applied professional research skills in accounting, auditing, and tax has become even more important for the successful future professional. Laws, regulations, and standards are changing faster than ever, creating a concern about standards overload, and the mastery of international financial reporting standards is widely needed and even influencing the Certified Public Accounting (CPA) exam. The authorities that accountants must research continue to proliferate. More information has become accessible through the development of extensive governmental and professional websites. Instant language translations of website information will impact accounting, auditing, and tax professionals around the world. The need for accessing specialized online research databases for selected information also continues to expand.

In response to these changes, students and professional staff need practice to apply their knowledge of professional research. Such work enables one to develop effective skills in research and analysis without fear of the potential penalties that increasingly apply in the real world. Success in the profession depends on one's ability to effectively and efficiently research, analyze, communicate, and master other key business skills.

*Accounting & Auditing Research: Tools & Strategies*, Eighth Edition is intended for integration into one's accounting education. The textbook is designed to serve both as an educational and reference tool for the practitioner or student who desires to become proficient in conducting professional research. The subtitle, *Tools and Strategies*, hints at the textbook's awesome integration of teaching and learning capabilities. Thus, *Accounting & Auditing Research: Tools & Strategies* enables users to find justifiable, authoritative solutions to accounting, auditing, tax, and business problems.

Various skills are developed in *Accounting & Auditing Research: Tools & Strategies*, Eighth Edition through reading and applying the knowledge presented. For example, the textbook enhances the reader's critical thinking and effective writing skills. Research and analysis skills are developed by completing exercises presented at the end of each chapter. The skills developed in the text help prepare students to conduct research in their future practice and for the CPA exam or other professional designations.

## NEW, REVISED, AND EXPANDED FEATURES OF THE EIGHTH EDITION

Although the emphasis of *Accounting & Auditing Research: Tools & Strategies*, Eighth Edition remains focused on providing useful guidance and information in conducting practical professional research, enhancements and updates in the Eighth Edition reflect the significant changes in accounting research sources and technological advancements.

Chapter 1 provides an introduction to applied professional research. Chapter 2 lays the foundation for critical thinking and effective writing skills needed for the professional

accountant. Chapter 3 explains the environment of accounting research in the United States. Chapter 4 demonstrates how to research U.S. GAAP in the updated Financial Accounting Standards Board (FASB) Accounting Standards Codification (Codification). Given that the U.S. economy is a significant part of the global economy, even foreign students should learn how to research U.S. GAAP.

Chapter 5 explains how to research international financial reporting standards issued by the International Accounting Standards Board (IASB). Even U.S. students need to understand the hierarchy of international accounting authorities and how to access and apply international financial reporting standards (IFRSs). The United States Securities and Exchange Commission (SEC) recognized the IASB as an official standard setter in accounting. Foreign companies may now file their financial statements with the SEC using IASB's IFRS without reconciling to U.S. GAAP. It is also possible that sometime in the future the SEC might allow U.S. public companies to start using IFRS.

Chapter 6 presents other financial accounting and legal databases, such as LexisNexis Academic. Commercial databases provide helpful information such as compiled financial ratios, insightful secondary sources, an easier ability to compare companies, and sometimes even analyst reports on a company. Chapter 7 teaches U.S. tax research for compliance and tax planning. Chapter 8 discusses assurance services and auditing research with additional discussion of the Auditing Standards Board's clarified auditing standards and the importance of professional skepticism. Chapter 8 also discusses the updated AICPA's Code of Professional Conduct and the utilization of the AICPA's professional online library for conducting research, which also is tested on the CPA exam.

After refining the research process in Chapter 9, its appendix provides an extensive list of acronyms and current website addresses of accounting, auditing, and tax organizations indexed by country. Thus, one is able to have the students make international comparisons of professional organizations, standard setters, and supervisory agencies. Chapter 10 provides the latest on fraud investigative techniques and additional tools and websites.

## RESEARCH DATABASES AND WEBSITES EMPHASIZED

The Eighth Edition has recognized the need to discuss various accounting, financial, and business databases, to which many colleges and universities subscribe. The following research tools are emphasized in the text:

- **ACL:** This audit and fraud investigation software package is one of the most widely used audit software packages in the world. It is used by both auditors and fraud examiners, as well as most accounting firms and internal audit departments. Chapter 10 discusses ACL.
- **AICPA Online:** This professional library or database includes a comprehensive collection of the American Institute of CPAs professional standards and literature, as well as access to the FASB Codification and Government Accounting Standards Board library.
- **Checkpoint:** This professional tax database contains a comprehensive research library for primary sources and secondary sources in U.S. federal taxation. Some subscriptions also have an accounting library. The database is covered extensively in Chapter 7.
- **FASB Codification:** The FASB's Accounting Standard Codification is the research database for conducting financial accounting research for the private sector under



U.S. GAAP. This database is available to educators and students through the American Accounting Association.

- **eIFRS:** Electronic International Financial Reporting Standards is the research database for conducting financial accounting research for the private sector under IFRS. These are the accounting standards adopted by most countries in the world.
- **i2:** The tool created by i2 Inc. is a visual investigative analysis software product. It assists investigators by uncovering, interpreting, and displaying complex information in easily understood charts. This tool is discussed in Chapter 10.
- **Internet:** Professional organizations, boards, and governmental agencies throughout the world have increasingly developed sophisticated website that assist students, accountants, auditors, and tax professionals. Chapter 9's appendix provides an extensive list of websites.
- **LexisNexis Academic:** This versatile research database is a subset of the widely recognized, commercial LexisNexis database. In addition to various topical areas of law, the database has a business library that provides extensive information on public companies. This database is presented in Chapter 6.

## ACCOUNTING CURRICULUM DEVELOPMENT OF RESEARCH AND ANALYTICAL SKILLS

Adopted over 30 years by many universities, *Accounting & Auditing Research: Tools & Strategies* has also assisted many public accounting firms and corporations in their professional staff training programs. This textbook guides the reader, step by step, through the research process. Faculty recognizing the essential need to incorporate research and analytical skills in the accounting curriculum will want their students to use this text for a comprehensive and systematic approach for learning the research and analytical skills needed for professional judgment.

This textbook has versatile usage in most areas of the accounting curriculum. Many faculty assign the text to supplement traditional accounting courses such as intermediate accounting, advanced accounting, international accounting, governmental accounting, auditing, theory, tax, or other courses. Alternatively, *Accounting & Auditing Research: Tools & Strategies*, Eighth Edition provides the information, insights, and research opportunities for a separate accounting, auditing, and tax research courses in an international environment. The publisher's website for the text provides assistance to faculty in using the text for various classes.

Research Tips presented in sidebar boxes throughout the textbook provide help in conducting common research tasks effectively and efficiently. Quick Facts sidebar boxes summarize and expand on chapter concepts to provide new and useful research information. Exercises are presented at the end of every chapter to reinforce the materials and further develop one's expertise in professional research.

## ACKNOWLEDGMENTS

Special thanks are extended to all the faculty members and former students who have used the author's materials and provided valuable suggestions for this new edition. The numerous accounting firms who have incorporated this text into their staff training programs are also appreciated.

Mahalo to the entities granting copyright permission to use screen images of their database or websites in order to enhance the readers' ability to understand. We appreciate the work of the professional staff at Wiley who have also enriched *Accounting & Auditing Research: Tools & Strategies*, Eighth Edition. Finally, we want to thank our supportive spouses and other family members who provided vital encouragement during the writing of this essential textbook.

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# ABOUT THE AUTHORS

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Professor Weirich has written numerous articles in professional journals and assisted others, such as by serving on the Editorial Advisory Board to the *Journal of Accountancy*. Professor Weirich has received many teaching and professional awards, including the School of Accounting/Beta Alpha Psi’s Outstanding Teaching Award, Ameritech/SBC Teaching Award, College of Business Dean’s Teaching Award, the Michigan Association of Governing Boards’ Distinguished Faculty Award, the Michigan Association of CPAs’ Distinguished Achievement in Accounting Education Award, and the Michigan Association of CPAs Accounting Teaching Excellence Award.

Extensive service was performed for national, state, and local committees, such as the American Accounting Association’s Education Committee, the SEC Liaison Committee, the AICPA’s SEC Regulation’s Committee, the Board of Examiners’ Auditing Subcommittee that aids in the development of the CPA examination, and National Association of State Boards of Accountancy (NASBA) CPA and Education committees. Dr. Weirich has also served as mayor of Mt. Pleasant, Michigan, and spent many years on its City Commission. He also served as chair of the Michigan Board of Accountancy.

## THOMAS C. PEARSON

**Thomas C. Pearson**, LL.M., JD, CPA, is a professor of accounting at the University of Hawaii at Manoa and former director of its School of Accountancy. He earned two masters of letters of law in tax from New York University and the University of Denver, a doctorate of jurisprudence and MBA from Vanderbilt University, and an AB from Dartmouth College. Professor Pearson received the George A. Katz Memorial Award in Securities Law in 2005. He has previously taught at the University of Wyoming and National Taiwan University. He has previous work experience at Hospital Corporation of America.

Professor Pearson has published approximately 40 articles, including the *Stanford Journal of Law, Business & Finance*, *North Carolina Journal of International Law and Commercial Regulation*, and the *Review of Banking and Financial Law*. He has also

published in leading accounting academic publications such as *Accounting Horizons*, *Journal of Accounting Education*, and *Journal of the American Taxation Association*.

His numerous teaching awards include the University of Hawaii's Board of Regents Teaching Excellence Award and the Outstanding Achievement in Education Award by the Hawaii Society of CPAs. He has served as president of the Shidler College of Business Faculty Senate and on numerous university committees. He has also served on Hawaii's Tax Review Commission and is involved in several professional organizations.

## NATALIE TATIANA CHURYK

**Natalie Tatiana Churyk**, PhD, CPA, is the Caterpillar Professor of Accountancy at Northern Illinois University. She earned her doctorate in accounting with a finance cognate from the University of South Carolina. She received her BS in accounting and her MBA with a specialization in finance from California State University, Long Beach. Dr. Churyk has public accounting experience with a local California firm.

Professor Churyk is the lead author in *Mastering the FASB Codification and eIFRS*. She has published in professional journals such as the *Journal of Accountancy*, *Strategic Finance*, and *CPA Journal*. She also has various academic publications in journals such as *Journal of Business Research*, *Journal of Accounting Education*, and *Advances in Accounting Behavioral Research*. Professor Churyk has received research grants from PricewaterhouseCoopers, the Institute of Management Accountants, and her university. Additionally, she has served on the editorial boards of *Journal of Accounting Education* and *Journal of Forensic and Investigative Accounting*.

Professor Churyk teaches in the undergraduate and LMAS programs. She also develops and delivers continuing professional education in Northern Illinois University's CPA Review program in addition to contributing to Wiley CPAExam Review: Financial Accounting and Reporting.

Her service has included presiding over several committees related to the American Accounting Association's Teaching, Learning and Curriculum and Forensic and Investigative Accounting sections, as well as various national and state committees on education, students, and/or women's initiatives. Active with student groups, Dr. Churyk is faculty advisor for ALPFA.

## LEARNING OBJECTIVES

After completing this chapter, you should understand:

- The importance of research in the daily activities of the professional accountant.
- The definition and nature of professional accounting research.
- The navigation steps to narrow one's research.
- The U.S. Securities and Exchange Commission's view on the importance of research.
- The role of research within a public accounting firm or within an accounting department of a business or governmental entity.
- The basic steps of the research process.
- The importance of critical thinking and effective communication skills.
- The importance of research on the U.S. CPA exam.

Today's accounting professionals, like other professionals, are witnessing a major transformation due to changes in the law, new services, technologies, and an ever increasing number of professional standards. In the altered accounting and auditing landscape brought about by these dramatic changes, understanding how to perform accounting, auditing, tax, and business research is more important than ever. To develop effective skills in research and analysis, students and professionals need to apply their knowledge of research to everyday practical problems. In addition to accounting, auditing, and tax compliance, accountants are involved in such services as attestation reviews, forensic accounting, fraud examinations, and tax planning. Listening effectively and understanding opposing points of view are also critical skills for accountants, who often must present and defend their views through formal and informal communications. Professional research and communication skills are essential in this environment.

Varying views and interpretations exist as to the meaning of the term *research*. In the accounting profession, research points to what accounting practitioners do as a normal, everyday part of their job. In today's environment, to become proficient in accounting, auditing, and tax research, they must possess the skills required to use various professional databases, which are increasingly available on the web. Using professional databases for research is even required on the CPA exam.

The professional accountant, whether in public accounting, industry, or government, frequently becomes involved with the investigation and analysis of an accounting, auditing, or tax issue. Resolving these issues requires formulating a clear definition of the problem, using professional databases to search for the relevant authorities, reviewing the authoritative literature, evaluating alternatives, drawing

### QUICK FACTS

Accounting research combines the use of accounting theory and existing authoritative accounting literature.

conclusions, and communicating the results. This research process often requires an analysis of very complex and detailed issues, and researching such issues challenges the professional's critical thinking abilities. The professional must therefore possess the expertise to understand the relevant facts and render a professional judgment, even when no single definitive answer or solution exists. In such cases, the researcher applies professional judgment in the development of an answer to the issue or problem at hand.

## WHAT IS RESEARCH?

Professional accountants conduct applied research primarily to practice issues. The objective of conducting any type of research, including professional accounting, auditing, and tax research, is a systematic investigation of an issue or problem utilizing the researcher's professional judgment. Here are two cases of generalized research problems that serve as examples of the types of research questions confronting the accounting practitioner:

1. A client is engaged in land sales, primarily commercial and agricultural. The company recently acquired a retail land sales project under an agreement stating that, if the company did not desire to pursue the project, the property could be returned with no liability to the company. After the company invests a considerable amount of money into the project, the state of the economy concerning the market for retail land sales declines, and the company decides to return the land. As a result, the client turns to you, the CPA, and requests the proper accounting treatment of the returned project. At issue is whether the abandonment represents a disposal of a segment of the business, an unusual and nonrecurring extraordinary loss, or an ordinary loss. The client may also want to understand the tax consequences.
2. A controller for a construction contracting company faces a problem. The company pays for rights allowing it to extract a specified volume of landfill from a project for a specified period of time. How should the company classify the payments for such landfill rights in its financial statements?<sup>1</sup>

Research is often classified as either theoretical or applied. *Theoretical research* investigates questions that appear interesting to the researcher, generally an academician, but that may have little or no current practical application. Theoretical researchers attempt to create new knowledge in a subject area, sometimes using empirical data based on experimentation or observation. For example, a theoretical researcher may conduct a controlled experiment to investigate the hypothesis that financial statement users' assessments of the relevance of an economic construct are influenced by factors underlying the reliability of its measurement.<sup>2</sup> Thus, theoretical research adds to the body of knowledge and may ultimately contribute directly or indirectly to practical problem solutions. Theoretical research using empirical research studies based on experimentation or observation are frequently reviewed and evaluated by standard-setting bodies in drafting authoritative accounting and auditing pronouncements.

*Applied research*, the focus of this text, investigates an issue of immediate practical importance. One type of applied research is known as *a priori (before-the-fact) research*,

<sup>1</sup> AICPA, *Technical Practice Aids*, vol. 1 (Chicago: Commerce Clearing House, Inc.).

<sup>2</sup> Kathryn Kadous, Lisa Koonce, and Jane Thayer, "Do Financial Statement Users Judge Relevance Based on Properties of Reliability?" *The Accounting Review* 87, no. 4 (July 2012).

which is conducted before the client actually enters into a transaction. For example, assume that a public accounting firm needs to evaluate a client's proposed new accounting treatment for environmental costs. The client expects an answer within two days on the acceptability of the new method and its impact on the financial statements. In such a case, a member of the accounting firm's professional staff would investigate to determine whether the authoritative literature addresses the issue. If no authoritative pronouncement exists, the accountant would develop a theoretical justification for or against the new method.

Applied research relating to a completed event is known as *a posteriori* (*after-the-fact*) research. For example, a client may request assistance preparing his or her tax return for a transaction that was already executed. Frequently, many advantages accrue to conducting a priori rather than a posteriori research. For example, if research reveals that a proposed transaction will have an unfavorable impact on financial statements, the client can abandon the transaction or possibly restructure it to avoid undesirable consequences. These options are not available, however, after a transaction is completed.

Society needs both theoretical and applied research. Both types of research require sound research design to effectively and efficiently resolve the issue under investigation. No matter how knowledgeable professionals become in any aspect of accounting, auditing, or tax, they will always face research challenges. However, using a systematic research approach will greatly help in resolving the problem.

### QUICK FACTS

Professional accountants conduct primarily applied research related to practice issues.

## RESEARCH QUESTIONS

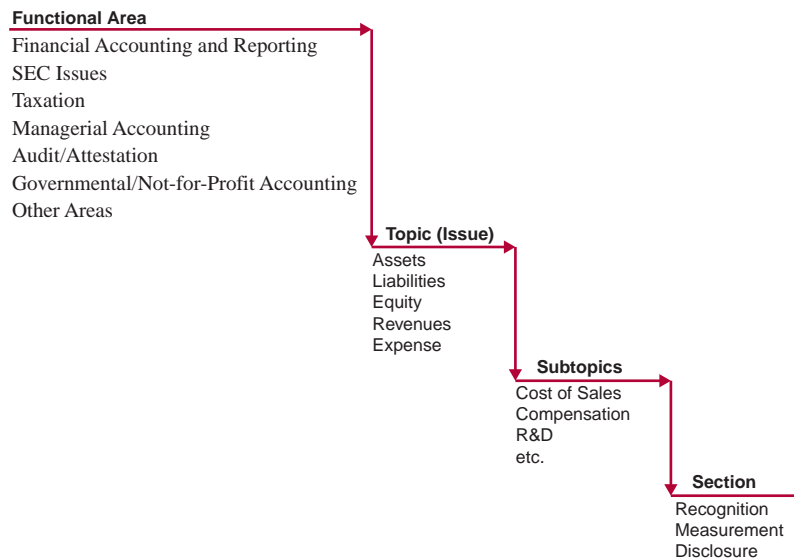
Individual companies and CPA firms conduct research to resolve specific accounting, auditing, and tax issues, either for themselves or for clients. The results of this research may lead to new firm policies or procedures in the application of existing authorities. In the research process, the practitioner/researcher must answer the following basic questions:

1. Do I have complete knowledge to answer the question, or must I conduct research to consult authoritative references?
2. What is the tax law or authoritative literature?
3. Does the law or authoritative literature address the issue under review?
4. Where can I find the law or authoritative literature and effectively and efficiently develop a conclusion?
5. Where can I find international accounting and auditing standards?
6. If no law or authoritative literature directly addresses the topic, what approach do I follow in reaching a conclusion?
7. What professional databases or other sources on the Internet should I access for the research process?
8. If more than one alternative solution exists, what alternative do I select?
9. How do I document my findings or conclusions?

The purpose of this text is to provide an understanding of the research process and the research skills needed to answer these questions. The whats, whys, and hows of practical

### RESEARCH TIPS

Successful research requires asking and answering various questions to find and apply relevant authorities.

**FIGURE 1-1** RESEARCH NAVIGATION GUIDE

professional accounting, auditing, and tax research are discussed with an emphasis on the following topics:

- How do I research effectively?
- How do I apply a practical research methodology in a timely manner?
- What are the generally accepted accounting principles, auditing standards, and tax authorities?
- What constitutes substantial authoritative support?
- What are the available sources of authority for accounting, auditing, and tax?
- What databases are available for finding relevant authorities or assisting in researching a problem?
- What role does the Internet (the information superhighway) have in the modern research process?

In conducting research for an issue or question at hand, one of the primary tools utilized in financial accounting research is the Financial Accounting Standards Board (FASB) Codification System<sup>TM</sup> (discussed in detail in Chapter 4). In addition to understanding the Codification's structure, navigating through the authoritative literature is necessary to analyze a variety of questions or issues. A useful instrument to help focus or narrow your research is a navigation guide such as the one depicted in Figure 1-1.

In navigating the literature or Codification, researchers should first focus on the functional area(s) that will guide them to the appropriate professional literature and/or database, as well as the authoritative body that issued the related literature. For instance, is the problem or issue under review a financial accounting question, managerial accounting issue, or technical Securities and Exchange Commission (SEC) problem? Once the functional area is determined, the next step in the navigation is to determine the



broad categorization of the topic, such as an asset, revenue, or expense issue. Then focusing on the subtopic allows for further segregation and navigation of the issue. For example, if the topical area is an expense issue, the subtopic might relate to cost of sales, compensation, or research and development.

The final phase in the navigation process is to focus on the section or nature of the content, which is often a recognition, measurement, or disclosure issue. For instance, if the functional area is financial accounting, the topic is assets, and the subtopic is financial instruments, the section or nature might address the proper measurement of the financial instrument either at cost or fair value. The navigation guide is explained in detail later in the text.

Also presented in the text is a practical research approach, along with discussions of various research tools and demonstrations of the approach using a number of end-of-chapter questions and exercises. The text also addresses the importance of critical thinking and effective writing skills that the researcher should possess and utilize in executing the research process. Specific tips on developing these skills are presented in subsequent chapters.

## NATURE OF PROFESSIONAL RESEARCH

This text focuses on applied research, known as *professional accounting research*. Today's practitioner must conduct research effectively and efficiently to arrive at appropriate and timely conclusions regarding the issues at hand. Effectiveness is critical in order to confirm:

- The proper recording, classification, and disclosure of economic events.
- Compliance with authoritative pronouncements.
- The absence of preferable alternative procedures.

Efficiency is needed to meet deadlines and manage research costs.

Additional examples of issues frequently encountered by the practitioner include such questions as:

- What are the accounting, auditing, or tax implications of a new transaction?
- Does the accounting treatment of the transaction conform with generally accepted accounting principles (GAAP)?
- Does the tax treatment conform with the law?
- What are the disclosure requirements for the financial statements or tax returns?
- What is the auditor's responsibility when confronted with supplemental information presented in annual reports but not as part of the basic financial statements?
- What responsibilities and potential penalties do tax accountants face?
- How does an accountant proceed in a fraud investigation?

Responding to these often complicated questions has generally become more difficult and time-consuming as the financial accounting and reporting requirements, auditing standards, and tax authorities increase in number and complexity. The research process is often complicated further when the accountant or auditor researches a practical issue or question for which no applicable authoritative literature exists.

### QUICK FACTS

The accounting researcher is an investigator with strong analytical and communication skills.

**RESEARCH TIPS**

Conducting research requires the use of electronic databases often available on the web.

As a researcher, the accountant should possess certain desirable characteristics that aid in the research process: inquisitiveness, open-mindedness, thoroughness, patience, and perseverance.<sup>3</sup> *Inquisitiveness* is needed while gathering the relevant facts to obtain a clear picture of the research problem. Proper problem definition or issue identification is the most critical component in research. An improperly stated issue usually leads to the wrong conclusion, no matter how carefully the research process is executed. Likewise, the researcher needs to be *open-minded* and avoid drawing conclusions before the research process is completed. A preconceived solution can result in biased research in which the researcher merely seeks evidence to support the position rather than searching for the most appropriate solution. The researcher must carefully examine the facts, obtain and review authoritative literature, evaluate alternatives, and then draw conclusions based on the research evidence. The execution of an efficient research project requires *thoroughness* and *patience*. This requirement is emphasized both in the planning stage, where all relevant facts are identified, and in the research stage, where all extraneous information is controlled. Finally, the researcher must work *steadfastly* in order to finish the research on a timely basis.

Perhaps the most important characteristic of the research process is its ability to add value to the services provided. A professional auditor not only renders an opinion on clients' financial statements but also identifies available reporting alternatives that may benefit them. A professional tax accountant not only prepares the returns but suggests tax planning for future transactions. The ability of a researcher to provide relevant information becomes more important as the competition among accounting firms for clients intensifies and the potential significance and enforcement of penalties become increasingly common. Researchers who identify reporting alternatives that provide benefits or avoid pitfalls will provide a strong competitive edge for their employers. Providing these tangible benefits to clients through careful and thorough research is essential in today's accounting environment.

## CRITICAL THINKING AND EFFECTIVE COMMUNICATION

Researchers need to know how to think; that is, they must identify the problem or issue, gather the relevant facts, analyze the issue(s), synthesize and evaluate alternatives, develop an appropriate solution, and effectively communicate the desired information. Such abilities are essential for the professional accountant in providing services in today's complex, dynamic, and changing profession. In this environment, the professional accountant must possess the ability not only to think critically, which includes being able to grasp a variety of contexts and circumstances, but also apply and adapt various accounting, auditing, tax, and business concepts and principles to the circumstances in order to develop the best solutions. The development and nurturing of critical thinking skills will also contribute to the lifelong learning that today's professionals need to nurture.

Research efforts may culminate in memos or work papers, letters to clients, journal articles, or firm reports. Whatever its form, the dissemination of your research will require effective communication skills for both oral presentations and written documents. Your research output must demonstrate coherence, conciseness, appropriate use of Standard English, and achievement of the intended purpose. Critical thinking and effective writing skills are the focus of Chapter 2.

**RESEARCH TIPS**

Successful research requires critical thinking and effective communication.

<sup>3</sup> Wanda Wallace, "A Profile of a Researcher," Auditor's Report, American Accounting Association (Fall 1984): 1-3.

## ECONOMIC CONSEQUENCES OF STANDARDS SETTING

It is often desirable, if not necessary, to investigate the economic consequences of accounting standard setting. Without this exploration, the establishment of a particular accounting standard may produce unintentional or unforeseen economic consequences. And accounting standards can have far-reaching economic consequences, as was demonstrated by the Financial Accounting Standards Board (FASB) in addressing such issues as restructuring costs, financial instruments and fair value accounting, stock options, and postemployment benefits. Difficulties sometimes arise in the proper accounting for the economic substance of a transaction within the current accounting framework.

Because financial statements must conform to GAAP, the standard-setting bodies, such as the FASB or Governmental Accounting Standards Board (GASB), conduct research on the economic impact of any proposed standard. For example, the handling of off-balance-sheet transactions has sometimes encouraged the selection of one business decision over another, producing results that may be less oriented to the users of financial statements.

In today's complex business and legal environment, the accounting and auditing researcher should understand the economic and social impact that accepted accounting alternatives may have on society in general and on individual entities in particular. Such economic and social concerns are becoming a greater factor in the evaluation and issuance of new accounting standards, as discussed more thoroughly in Chapter 4.

## ROLE OF RESEARCH IN THE ACCOUNTING FIRM

Although accountants often conduct research in education, industry, and government, the particularly important areas for a public accounting firm are accounting, auditing, and tax. Reflecting today's society, significant changes have occurred in the accounting environment. The practitioner today requires increased knowledge because of the heightened complexity of many business transactions, the proliferation of new authoritative pronouncements, and advances in technology. As a result, practitioners should possess the ability to conduct efficient research. An accountant's responsibility to conduct accounting/auditing research is analogous to an attorney's responsibility to conduct legal research. For example:

- A lawyer should provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation.<sup>4</sup>
- A California court interpreted the research requirement to mean that each lawyer must have the ability to research the law completely, know the applicable legal principles, and find “the rules which, although not commonly known” are discovered through standard research techniques.<sup>5</sup> Thus, in the California case, the plaintiff recovered a judgment of \$100,000 in a malpractice suit that was based on the malpractice of the defendant in researching the applicable law.
- The U.S. Securities and Exchange Commission has also stressed the importance of effective accounting research through an enforcement action brought against an

### QUICK FACTS

The accounting practitioner may be held liable for inappropriate or incomplete accounting or tax research.

<sup>4</sup> Model Rules of Professional Conduct of the American Bar Association, Rule One.

<sup>5</sup> *Smith and Lewis*, 13 Cal. 3d 349, 530 P.2d 589, 118 Cal Rptr. 621 (1975).

accountant. In Accounting and Auditing Enforcement Release No. 420, the SEC instituted a public administrative proceeding against a CPA. The SEC charged that the CPA failed to exercise due care in the conduct of an audit. The enforcement release specifically stated the following:

In determining whether the [company] valued the lease properly, the [CPA] failed to consult pertinent provisions of GAAP or any other accounting authorities. This failure to conduct any research on the appropriate method of valuation constitutes a failure to act with due professional care.

Thus, the professional accountant must possess the ability to use relevant sources to locate applicable authoritative pronouncements or law and to ascertain their current status. Due to the expanding complex environment and proliferation of pronouncements, many accounting firms have created a research specialization within the firm. Common approaches used in practice include the following:

1. The staff at the local office conducts day-to-day research, whereas industry-specific questions are referred to industry specialists within the firm.
2. Selected individuals in the local or regional office are designated as research specialists, and all research questions within the office or region are brought to their attention for research.
3. The accounting firm establishes at the firm's executive office a centralized research function that handles technical questions for the firm as a whole.
4. The firm maintains computerized files of previous research to provide consolidated expertise on how the firm has handled issues in the past.

#### RESEARCH TIPS

At times, conducting research will require consulting with research specialists.

The task of accurate and comprehensive research is often complex and challenging. However, one can meet the challenge by becoming familiar with the suggested research process to solve the accounting, auditing, or tax issues.

Figure 1-2 depicts a more in-depth look at a typical organizational structure for policy decision making and research on accounting and auditing matters in a multioffice firm that maintains a research department. The responsibilities of a firm-wide accounting and auditing policy decision function include:

- Maintaining a high level of professional competence in accounting and auditing matters.
- Developing and rendering high-level policies and procedures on accounting and auditing issues for the firm.
- Disseminating the firm's policies and procedures to appropriate personnel within the firm on a timely basis.
- Supervising the quality control of the firm's practice.

Research plays an important role in this decision-making process. A CPA firm's policy committee and executive subcommittee, as shown in Figure 1-2, generally consist of highly competent partners with many years of practical experience. The policy committee's primary function is to evaluate significant accounting and auditing issues and to establish firm-wide policies on these issues. The executive subcommittee's function is to handle the daily ongoing policy (lower-level) decisions for the firm as a whole. The responsibility of the accounting and auditing research personnel is to

FIGURE 1-2

## ORGANIZATIONAL FRAMEWORK FOR POLICY DECISION MAKING AND RESEARCH WITHIN A TYPICAL MULTIOFFICE ACCOUNTING FIRM



interpret firm policies in the context of specific client situations. Frequently, technical accounting and auditing issues that arise during the course of a client engagement are resolved through research conducted by personnel assigned to the engagement. When a local office cannot resolve a research matter satisfactorily, assistance is requested from the firm's specialized research units. These units conduct careful and comprehensive research in arriving at the firm's response to technical inquiries. This response is then disseminated to the various geographic offices of the firm for future reference in handling similar technical issues.

Practical accounting and auditing research is not confined to public accounting firms. All accountants should possess the ability to conduct effective research and develop logical and well supported conclusions on a timely basis. The basic research process is similar whether the researcher is engaged in public accounting, management accounting, governmental accounting, auditing, or even taxation.

## RESEARCH AND THE CPA EXAM

In the licensing of a new CPA, state laws or regulations typically require a combination of education, examination, and experience. State legislatures, state boards of accountancy, the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA) have strived to assure the professional competencies of CPAs. The role that a CPA plays in society is so significant that the AICPA Board of Examiners has identified certain skills that the beginning CPA must possess in order to protect the public interest:

- **Understanding:** The ability to recognize and comprehend the meaning and application of a particular matter.