TIP from the Trenches

Students are often confused by the role of industry guidance in the Codification. Remember: Industry guidance in the Codification generally applies *in addition to* other general Codification content.

Now YOU Try 2.1

Describe what types of entities the Codification applies to. Does it apply equally to these entities? Explain.

____

____

What Sources of Guidance Were Used to Populate the Codification?

LO2 **Identify** standard setters that have contributed to the current body of authoritative guidance.

The Codification is an aggregation of many, many accounting standards issued over the course of the past century. These include, for example,[4]

- FASB Statements and Interpretations,
- Emerging Issues Task Force (EITF) Abstracts, and
- AICPA Statements of Position.

Additionally, the Codification includes all still-effective guidance from the two standard-setting bodies that preceded the FASB, namely,

- The Committee on Accounting Procedure (CAP), which issued Accounting Research Bulletins (ARBs) and
- The Accounting Principles Board (APB), which issued APB Opinions.

In 2009, when the guidance from these original standards was moved into the Codification, the original standards were superseded and became *nonauthoritative*. Today, these so-called *pre-Codification standards* still serve a limited role in research. This role is discussed further in Chapter 5, which describes the use of nonauthoritative guidance.

Figure 2-1 depicts the many sources of guidance used to populate the Codification. All guidance in the Codification today has equal authority.

Figure 2-1 Sources of guidance used to populate the Codification

Key Standard Setters and Guidance Issued

Committee on Accounting Procedure (1939–1959)
– Issued ______________________

Accounting Principles Board (1959–1973)
– Issued APB __________ and related AICPA Accounting Interpretations (AIN)

Financial Accounting Standards Board (1973–present)
– Issued FASB __________ and __________, as well as Technical Bulletins, Staff Positions, and Staff Implementation Guides

Other Standard-Setting Bodies and Guidance Issued

– **Emerging Issues Task Force:** Issued EITF __________ and D-Topics
– **Derivatives Implementation Group:** Issued "DIG" issues
– **AICPA:** Issued ________________, Practice Bulletins, plus certain content from Technical Inquiries and Audit & Accounting Guides

These original standards were __________ when the Codification became effective. All guidance in the Codification has ______ authority.

The APB was in existence from 1959 to 1973 but issued its first Opinion in 1962. The CAP was replaced by the APB in 1959.

[4] To view the complete list of guidance used to populate the Codification as of its adoption in 2009, consult the FASB notice *About the Codification,* accessible from the homepage of the Codification.

Payable to Company Founder Jensen Inc. has a $500,000 note payable due to its founder, Jen Jensen. Ms. Jensen is recently deceased and has no heirs that Jensen Inc.'s executive team is aware of. The company has asked for your help to determine whether it is appropriate to derecognize the liability from its financial statements. **2.4**

Required:

1. Respond to Jensen Inc. Describe the applicable guidance requirements, including excerpts as needed to support your response.
2. Next, explain how you located the relevant guidance, including the search method used and which section you searched within the appropriate topic.

Goodwill Accounting Alternative An "accounting alternative" is available within the Goodwill topic of the Codification (ASC 350-20), specifically as it relates to the subsequent measurement of goodwill. Locate this alternative, and explain: 1) What measurement approach does the accounting alternative permit?; 2) What types of companies are eligible to apply this accounting alternative, and where did you locate this information?; 3) How does the accounting alternative differ from the measurement requirements for companies that do not (or cannot) elect this treatment?; 4) What was the effective date for this guidance, and where did you locate this information? **2.5**

Applying Transition, Effective Date Guidance You are on the audit team for a publicly traded insurance company with a calendar year-end. The company needs help understanding the FASB's recent standard (ASU 2018-12) on insurance contracts and has asked you the following questions: 1) In what annual period are we first required to apply the new standard? 2) In what interim period? 3) When we apply the new standard, are we required to recast comparative periods to conform to the new requirements? 4) What topic does this ASU update within the Codification? 5) What are some of the key changes brought about by this new standard? **2.6**

For each question, explain where within the guidance (ASU or Codification) you located the information.

Early Payment Discount Jones Equipment is a private company that sells and installs HVAC systems. Jones offers payment terms of 2/10, n/30, where customers making payment within 10 days of installation will receive a discount of 2% off the purchase price or must pay the full balance due within 30 days. Jones has just received payment from a new customer who paid within the 10-day window and is thus entitled to the 2% discount. The gross sales price of the equipment and installation, before discount, was $10,000. This discount will not result in a loss to Jones on the sale of the product and service. Jones needs your help to determine when the 2% early-payment discount should be recognized and how it should be recorded—for example, as a reduction in revenue or as a cost of sales? **2.7**

1. Citing from the guidance as support, show the approximate journal entries that Jones would make upon installation of the equipment and upon receipt of customer payment. 2. Explain how you located the relevant guidance, including the search method used and which section you searched within the appropriate topic.

Case 2.7
Instruction clarification:
Please use ASC 606 (the revised revenue model) and not ASC 605 (the superseded revenue model) in researching your response.

Determining Inventory Costs Pro Packs, Inc. manufactures its own backpacks, marketed to customers primarily for camping and travel needs. The company is reviewing its policy for capitalizing inventory costs and wants your help to determine whether the following costs should be capitalized as part of the cost of inventory: 1. Canvas used in the construction of the packs; 2. Zippers purchased from YKK (a supplier), including the cost of freight for the zippers to be shipped; 3. Wages paid to employees operating industrial sewing machines; 4. Electric utility bills related to operation of the plant; and 5. Contract labor paid to update and maintain the company website, through which customers can directly place backpack orders. For each cost noted, explain your position and the source you consulted. **2.8**

Purchase of a Vineyard Your client has just purchased land on which it intends to build a vineyard. In doing so, the client incurs the following costs: 1) land surveys; 2) costs of leveling the land; 3) installation of fencing; 4) installation of a sprinkler system. Refer to industry guidance in the Codification to determine whether these costs should be capitalized and whether there are restrictions surrounding the capitalization period. Also, educate your client on how the Codification classifies these different types of costs. Finally, locate one other example of a cost that may be capitalized and explain any restrictions on the period during which the cost may be capitalized. **2.9**

Falling Boxes On January 31, an improperly stacked box fell from the top shelf of a warehouse, injuring an employee. The employee was hit, fell, and broke his wrist. Your company self-insures for the risk of such incidents rather than paying an insurance company to absorb the risk of such claims. The employee has been treated for his injuries and has retained a lawyer. The lawyer has not yet filed a formal claim with the company. According to your internal risk management team, the amount of claim likely to be sought by the employee could range between $50,000 and $300,000. Is your company required to record a liability for this incident? When, and for what amount? What disclosures are required, if any? **2.10**

Sale of Custom Merchandise Custom Wares is a public company that sells custom merchandise, including engraved picture frames. On December 15, the company received a purchase order and payment from a customer (Jim Burke) for the purchase of 200 custom frames. The frames will be used as a wedding favor and engraved "Jim and Jess, 2020." **2.11**

at a fixed price on a certain future date.

5. You are once again in the first step of the research process (understanding the facts). Now, your company is looking to repurchase some of its outstanding stock. You are about to attend a meeting between representatives of your company's Treasury department and a bank at a fixed price on a certain future date. Identify three resources you could consult, or questions you might ask of others on your team or in the organization, to gather additional background/precedent for this issue before you attend the meeting.

Identify at least one researchable question for each of the following issues (in questions 6–12).

6. A cable network has just entered into an agreement granting it the right to show reruns of a hit TV series. In exchange for this right, the network must pay the TV show's creators a fee each time the show airs.
7. An online restaurant booking site sells a $100 meal voucher, good for $100 toward a meal at Randall's Steakhouse, to a customer for $60. When the customer presents the voucher to Randall's Steakhouse, the restaurant booking site must remit $50 to Randall's, retaining $10.
8. A company's auditor is questioning the appropriateness of the company's discount rate assumption, which it uses to measure its defined benefit pension obligation.
9. Coal, Inc. has paid $10 million to a waste disposal company to clean a site originally contaminated by Coal, Inc. through its operations and to assume its environmental liability (currently recorded as an $10 million liability on Coal's financial statements). State regulators have signed off on the liability transfer and now look to the waste disposal company as the responsible party for the cleanup.
10. Automotive, Inc. has announced the sale of its Truck Division's three plants, along with planned layoffs of the Truck Division's employees. Automotive, Inc. is hoping to segregate the results of the Truck Division's operations in its financial statements. Identify at least two possible research questions.
11. Your company is planning to issue equity securities with attached call options, where the company can repurchase the securities at a specified price if future events occur.
12. For the following researchable question, identify two additional questions that might arise as the researcher digs deeper into the research topic. Assume that a company has just sold a portfolio of mortgage loans in exchange for cash and certain retained interests in the loans receivable. The initial question: Can the company record the transfer as a sale?
13. Stop and think. In this example, you'll be asked to stop and think about an issue, then to search the Codification for applicable guidance.
    a. Stop and think. Your company sells seasons passes to a waterpark that it owns. The passes are good from June 1 to September 30 of a given year. The company must determine the appropriate pattern of recognition for recording this revenue. What does your instinct tell you?
    b. Now, perform research within the Codification to find guidance on this issue. How does the authoritative guidance describe this issue?
    c. Finally, consider: Was your instinct consistent with the guidance for this issue? How did this instinct help you evaluate the guidance you found?
14. Identifying alternative accounting treatments: A joint venture was just formed, and one of the venturers (companies that invested in the JV) contributed a technology patent with a basis of $5 million and an estimated fair value of $9 million. List two accounting measurement alternatives available for the joint venture to recognize the contributed patent. Explain. (Notably, the Codification does not directly provide guidance for this issue, so your goal during this exercise is just to brainstorm.)
15. What are two types of "Accounting Changes" described in the Codification? Identify these "alternative" types of accounting changes, and cite where you found these listed in the Codification.

For each of the following sample scenarios (in questions 16–19), identify one or more biases that could be at play, then explain.

16. A judge ruling in a securities fraud case found a corporation guilty of misleading investors because the company's disclosures predicted that a new drug would likely receive FDA approval years before the actual approval came through. What bias may have been at play for the judge in reaching this ruling?
17. Growth rates in sales had slowed versus the prior year. A task force was convened that consisted of senior vice presidents from across the company, plus one executive vice president (the COO). The COO came to the meeting prepared to offer a solution. When she did, the group agreed it was the appropriate path forward and set in motion a plan to implement her recommendation.
18. Upon adoption of the new revenue standard, a company wrestled with a gross versus net accounting policy judgment and ultimately rationalized that it should likely continue its current position unless there was a compelling reason in the guidance to change.

[Hint: This letter (b) example starts with a *strong* reference, but the reference doesn't flow with the rest of the quote. Find a way to fix this.]

13. Introduce the following guidance using a strong reference, then indent the guidance following your introduction. Split the guidance reference (topic-subtopic), (section-paragraph) in a manner similar to the example shown on p. 96.

    ASC 210-10-45-13 **(Balance Sheet)**

    Asset valuation allowances for losses such as those on receivables and investments shall be deducted from the assets or groups of assets to which the allowances relate.

14. In the following excerpt, explain why *brackets* [ ] are present (e.g., what are the two functions of the brackets in this example?). Also, explain why it's necessary for the researcher to show any changes to quoted text in brackets.

    Per ASC 842-10-15-3: "A contract is or contains a lease if the contract conveys the **right to control** the use of identified [PP&E] (an identified asset) for a period of time in exchange for consideration." [Emphasis added]

CASE STUDY QUESTIONS

4.1 **Presto Hospitality—Lease Scope** In Case Study 3.5, you researched whether Presto has the right to substantially all economic benefits from use of the identified assets. Now, research whether Presto has the **right to direct** use of the identified assets. In doing so, assume that the stadium owner has the right, per contract, to require Presto to change the "concept" offered at the concession stands at its option. For example, Stadium Owner could require that a hot dog stand be changed out for a pizza concept. However, assume, in practice, that the stadium owner may only exercise this authority once per year, perhaps for one concession stand out of the several stands run by Presto. Also, assume that Presto can recommend pricing to the Stadium Owner, but ultimate approval authority rests with the Stadium Owner.

As necessary, identify additional questions you might ask—or facts you might gather—in order to fully research this question.

Next, benchmark against peer disclosures: Do other companies with similar activities report these contracts as leases?

4.2 **Presto Hospitality—Lease Scope** Describe the decisions in the Presto Hospitality arrangement that are *predetermined* versus decisions that remain to be made throughout the contract term. These are the decisions that comprise right to direct.

4.3 **Presto Hospitality—Lease Scope**

a. Evaluate how Presto's lease scope assessment would be impacted if the arrangement were priced differently. For example, would you conclude that the arrangement is a lease if the contract is called a Management Agreement and the arrangement is priced such that Presto earns a fixed management fee of $100,000 per year? Assume in that case that all operating profit or loss would be borne by Stadium Owner.

b. What if Presto earns a fixed fee of $85,000 per year + 1% of gross sales + 10% of profits? How does this pricing affect your analysis of lease scope?

4.4 **Presto Hospitality—Lease Scope** A colleague in your accounting policy group came across guidance in Deloitte's lease accounting Roadmap publication that describes a concept of functional independence. Your colleague believes Presto could make the case that its concession stands are not "functionally independent" of the stadium, noting for example that Presto cannot independently market its stands to customers unless those customers have a ticket to enter the stadium. Evaluate the strength of this argument, and describe the implications of taking this position on Presto's accounting.

4.5 **Presto Hospitality—Revenue Recognition** Assume Presto concludes that its concession agreement with Stadium Co. is not a lease. In that case, apply the five-step revenue process in ASC 606 to this arrangement. Assume you are evaluating appropriate revenue recognition for the contract and for individual transactions that will arise within the scope of the contract (for example, a sale of a hot dog to a customer in the stadium). Assume a hot dog retails for $6, of which Presto retains 50%.

4.6 **Baseball Suites—Lease Evaluation** The New York Yankees offer multiyear luxury suite licenses to customers, including 3-, 5-, and 10-year licenses. Customers who sign these license agreements have the right to use a specified suite in the stadium (say, suite no. 25) for the dates specified in the license agreement. Alternatively, customers with a more limited interest or budget can sign up for a partial season (a 20- or 41-game plan) where the customer can specify which games it wishes to view from the suite. While the customer is enjoying the suite, a third-party conces-

Properly referencing nonauthoritative guidance

19. Correct the errors in the following source citation. Assume this is the first time this source is being mentioned in an issues memo.

> Concept 8 states, with respect to financial statement footnotes: "Notes to financial statements are subject to the same cost constraint that applies to financial reporting."

20. Circle each of the required elements shown in the following source citation. Then describe each of the required elements that was appropriately included in this reference.

> Per FASB Statement No. 5, *Accounting for Contingencies* (FAS 5), par. 8: "An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met . . ."

21. Determine what is improper about the following nonauthoritative reference, then explain why.

> PwC's guide, *Business Combinations and Noncontrolling Interests* (2017), Sec. 1.2 defines a **business** as: "…an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants."

CASE STUDY QUESTIONS

5.1 **Using Firm Guidance to Research a Revenue Question** You are an accountant working for Hotel Co. Your supervisor has asked you to research what amount of revenue Hotel Co. should recognize for transactions booked by customers on Expedia.com. Expedia generally collects the full transaction price from the customer, then withholds a small fee (say, $10) from each transaction and remits the balance to Hotel Co. Should Hotel Co. record the gross transaction fee or only the net amount it receives from Expedia.com? Use nonauthoritative firm guidance to assist in your response.

5.2 **Variable Rents—A Liability?** Assume a company pays $10,000 per month plus 2% of sales ("a variable rent charge") to occupy a retail space in a mall. The lease agreement has a 3-year noncancelable term. Based on prior history in that location, the company estimates that its variable rent charge will amount to approximately $1,000 per month.

a. Using the Conceptual Framework, evaluate whether this variable rent charge meets the definition of a liability.
b. Next, locate discussion in the Basis for Conclusions of ASU 2016-02 (Leases) and describe how the FASB considered this issue of whether variable rents should be included in the lease liability recognized by companies. Describe some of the history of this issue—did the Board always hold the view that variable rents should/should not be included in companies' lease obligations?

5.3 **Rail Grinding** Rail grinding is a maintenance activity conducted on railroad tracks that is designed to remove irregularities and imperfections from the track in order to allow for faster travel speeds on the track and to increase the lifespan of tracks.

a. Using the Conceptual Framework, evaluate whether the cost of rail grinding activities should be capitalized as an asset or reported as an expense.
b. Using SEC.gov, company filings, full text search, look for disclosures from companies in the industry to benchmark how the industry treats these costs.
c. Also using SEC.gov, search for CORRESP between the SEC and BNSF railroad. Describe the SEC's position on this issue.

5.4 **Conceptual Views on Materiality** Using CON 8, describe the role of *materiality* in understanding the qualitative characteristics of useful financial information. Specifically, assume you are describing materiality to a small-business owner who is trying to determine what information must be reported to his financial statement users. Next, comment on what the Board's basis for conclusions says about the issue of materiality and its considerations in recently amending the guidance around this concept.

5.5 **Improving Your Familiarity with CON 7 Present Value Techniques** As noted within the chapter, CON 7 describes techniques for calculating present value, including the following illustration of the *expected cash flow approach*, reproduced from CON 7. This example illustrates how the expected cash flow approach can be used to assign probability factors to the likelihood of receiving a $1,000 cash flow in any of three possible future years.

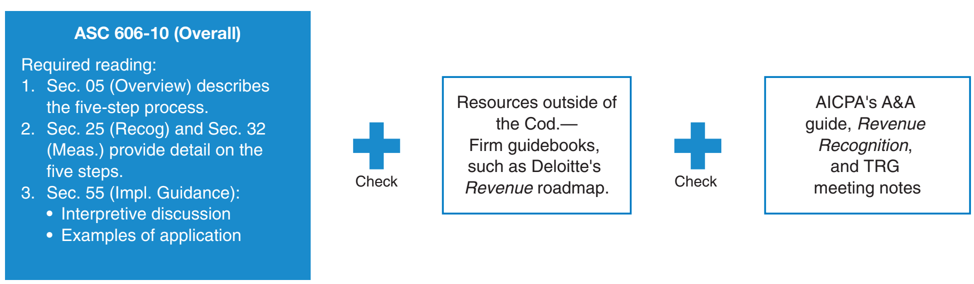
What it also means is that—where the FASB issues *principles*, practice is left to develop interpretive guidance. Several players had a part in interpreting the FASB's revenue principles:

- The **Transition Resource Group (TRG)**, formed by the FASB and IASB to address implementation questions raised during entities' adoption efforts. Meetings of the TRG prompted several authoritative revisions to the FASB and IASB's revenue standards, and also resulted in meeting notes that are considered an important part of the nonauthoritative body of revenue interpretive guidance.[15]
- The **AICPA's revenue recognition task forces**, made up of industry specialists from 16 different industries. These task forces discussed application of the ASC 606 principles to key transactions for each industry and developed whitepapers for each issue discussed. These papers, once finalized, were published in the **AICPA's A&A guide, *Revenue Recognition***.
- Major accounting firms, which publish accounting guide books offering extensive explanation, examples, and interpretive discussion of the revised revenue model. One such example is Deloitte's *Revenue* roadmap publication.

Therefore, while you may only have one principles-based subtopic to review in the Codification (ASC 606-10), consider it *mandatory* to review nonauthoritative interpretive guidance when researching revenue questions.

EXAMPLE

For example, you might navigate **ASC 606-10** and additional interpretive guidance as follows.



TIP from the Trenches

Take the time to read ASC 606. Revenue is the most significant number on almost every company's income statement, so it is important that you are comfortable with the principles in the new model.

Let's now walk through a sample research question using the revised model. The focus of the example is not to challenge you with complex guidance; rather, it is to show you the process involved in researching and applying the revised revenue model.

Cuppa Joe: Applying the Five-Step Revenue Model

Facts: Cuppa Joe, a coffeehouse chain, sells beverages and premium homemade foods. The Company offers a popular loyalty program whereby customers can purchase 10 cups of coffee and get the 11th cup free. Customers must present their punch card with every purchase to

[15] TRG papers are not considered authoritative, but "ignore them at your peril," said an IASB Board member. She may have been referencing the following guidance, from a speech by Wesley R. Bricker, SEC Deputy Chief Accountant. May 5, 2016. Refer to SEC website at https://www.sec.gov/news/speech/speech-bricker-05-05-16.html. Mr. Bricker encouraged entities to consult the SEC's Office of the Chief Accountant if they planned to apply the standard "in a manner differently from the manner in which TRG members believed the guidance should be applied."

Recognition

15. In addition to the four fundamental recognition criteria from CON 5, what two additional factors should a financial statement preparer consider before recording an item?
16. What four additional sources (in addition to Section 25) might a researcher consult for recognition-related guidance?
17. The chapter notes that derecognition guidance (Section 40) in the Codification is somewhat limited, but that derecognition can take place through other means, and this type of guidance can be found in other sections of the Codification. Explain this statement.
18. What is a *recognition threshold*?
19. Contrast the existing CON 5 versus CON 6 approaches to revenue recognition. Which model is more similar to the revised revenue recognition model?
20. What is the role of the FASB's Transition Resource Group?
21. To locate guidance about the five steps in the revised revenue model, a researcher should consult (at a minimum) the ___________ and __________ sections in ASC 606.
22. Contrast the process for reviewing guidance within the superseded revenue recognition topic to the process you would apply to navigate the revised topic. Which model (superseded or revised) requires consideration of more subtopics? Explain.
23. Why is it important to determine whether promises made to the customer are distinct? What's the significance of this concept?
24. What is the basic threshold for recognition of an uncertain tax position?
25. What does it mean for a tax position to be *effectively settled*?
26. Explain what it means for a subsequent event to be *unrecognized*. Provide one example.
27. How does an in-substance defeasance differ from a legal defeasance? Can both result in the extinguishment of a liability?

EXERCISES

Respond to the following in complete sentences, and cite your source. If you have to make any assumptions in your response, state what you assumed. Responses should primarily come from the Codification, unless otherwise noted.

Scope Exercises

1. Does the Research and Development—Overall topic within the Codification apply to activities that are unique to entities in the extractive industries, such as exploration? Explain or cite from the relevant paragraph.
2. Does the Income Taxes topic apply to an entity's operations that are accounted for under the equity method? Explain.
3. Within the scope section of ASC 815-10 (Derivatives), which guidance comes first—the definition of a derivative, or scope exceptions to this topic? Explain.
4. What is an example of a transaction that is outside the scope of ASC 842?
5. Which entities are subject to Earnings Per Share guidance within the Codification?
6. Is environmental contamination incurred in the normal operation of a long-lived asset within the scope of the Codification's Environmental Obligations guidance?
7. A company has entered into a forward contract for the purchase of gold, in 2 years, for $1300/oz. Does this arrangement meet the definition of a derivative? Analyze all required parts of the definition. (You may simply refer to the guidance excerpts included within this chapter to respond.)
8. Name three examples of organizations that are within the scope of healthcare entities industry guidance.
9. Does the Nonmonetary Transactions topic apply to transfers of goods from an entity to its customers in exchange for noncash consideration? Explain.

11. Using EY's *Financial Reporting Developments* publication, *Fair Value Measurement*, look for the discussion of *market participants*, in the context of understanding broad fair value concepts. What is the role of market participants in measuring fair value, and is it necessary for an entity to identify specific market participants when forming fair value assumptions?

12. Explain when an impairment loss should be recognized for intangible assets other than goodwill.

13. How could the unit of account selected affect whether an item of PP&E is impaired? For example, consider whether impairment is more likely if just one asset is tested versus whether multiple assets are grouped into a unit of account then tested.

14. Can the carrying value of PP&E held for sale ever be "written up" (increased)?

15. Name two circumstances in which the carrying amount of property, plant, and equipment (PP&E) may not be recoverable and should be tested for impairment.

16. In Section 35 (Subsequent Measurement) of ASC 820, what guidance is offered for determining the *implied fair value* of goodwill? What does this mean?

CASE STUDY QUESTIONS

Spoiled Cheese? Recall Frankie's Homemade Cheese Shop from the Chapter 7 cases. Assume now that Frankie's has finished construction of the new cheese superstore along Route 5 and capitalized $1.9 million related to the project as of the store's opening on 1/1/20X1. As of 12/31/X1, the current carrying value of the shop is $1.805 million (assuming a 20-year life for the store and straight-line depreciation). As of 12/31/X1, Frankie's notices that a few negative factors are at play and asks you whether it is required to test the superstore for impairment: 1. A key stock market index (the Dow) has slid 1,500 points, or 6%, since the store was opened. 2. Monthly sales have slid by 10% since the store was opened, partially due to a construction project on Route 5 that has reduced traffic flow to the area. 3. As a result of the slide in monthly sales, the store operated at a deficit in October, November, and December of 20X1. **8.1**

Assume the fair value of the store at 12/31/X1 is $1.7 million. As of 12/31/X1, Frankie's estimates the store will produce net cash inflows of $50,000 in year 2, $100,000 each in years 3–5, $150,000 each in years 6–10, $175,000 each in years 11–15, and $200,000 each in years 16–20. Note that Frankie's incremental borrowing rate is 6%.

Is the store required to be tested for impairment? Should Frankie's impair the current carrying value of the store at 12/31/X1?

Fueling Up On 1/1/X1, Airline Inc. signed a purchase agreement to purchase 10,000 gallons of jet fuel from Seller Co. for $5.20 per gallon on 12/31/X3. The contract stipulates that, at settlement on 12/31/X3, Airline Inc. can choose to either accept physical delivery of the jet fuel or can accept settlement in cash of the difference between the then-current market price and the contract price for the jet fuel. At the time the contract was signed, jet fuel was selling for $5.15 per gallon. On 12/31/X1, jet fuel was selling for $5.25 per gallon. As of 12/31/X2, jet fuel was selling for $5.30 per gallon. What entries should Airline Inc. record as of 1) contract inception, 2) then at 12/31/X1, 3) then at 12/31/X2? **8.2**

Friendly Contribution A new children's hospital is being built in Springfield, and Friendly Corp. has publicly pledged that it will contribute $5 million toward the hospital's construction. In its pledge agreement dated 1/1/X1, Friendly Corp. and the hospital have agreed upon the following contribution schedule: $2 million to be contributed at 12/31/X1, $2 million at 12/31/X2, and $1 million at 12/31/X3. Friendly's typical borrowing rate is 6%. How must Friendly Corp. report the contribution in its financial statements at the end of each reporting period and as of the inception of the agreement? What disclosures are required, if any? **8.3**

Dealer Financing On 1/1/X1, Tractor Co. sold a new combine to Jim's U-Pick farm. The purchase agreement establishes a base price of $100,000, plus a contractual interest rate of 5%, payable in 48 monthly installments of $2,302.93. Control of the combine transferred to Jim when Jim signed the contract and had the combine delivered that same day. If Jim had obtained separate financing (say, a bank loan) for the purchase, his interest rate would have been 6%. **8.4**

What amount of revenue should Tractor Co. record at the date of sale? What guidance should Tractor Co. apply to the subsequent measurement of its receivable?

Consider the measurement attribute used to record Tractor Co.'s revenues. How does this approach achieve the objective of this measurement attribute?

Hint: You might find it useful to use Microsoft Excel's formula options: PMT and PV for this example. Excel walks you through how to input numbers into each formula.

20. Explain the meaning of the terms threats and safeguards and provide two examples of each.
21. Must a CPA always apply safeguards after a threat has been identified? In what circumstance might a researcher not have to identify and apply safeguards?
22. Aside from auditing standards, what are some of the other professional standards issued by the AICPA?
23. Which type of standard should an accountant apply, if he or she is performing a financial statement review for a client? Also, what specific standard number provides a framework for performing review engagements?
24. Explain why documentation is critical to audit research. Then, complete the following sentence: Prepare your auditing documentation with the expectation that __________________.

EXERCISES

Code of Conduct Exercises

***Instructions:* Answer the following in complete sentences using the AICPA's revised Code of Conduct, providing the ET references for each of your responses. For questions with multiple parts, include multiple ET references as appropriate.**

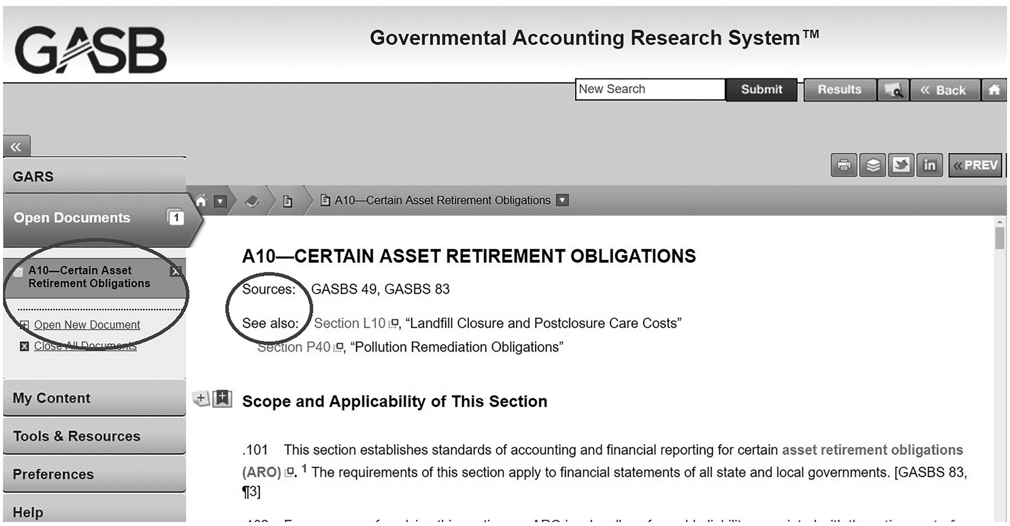
1. According to Appendix A of the Code, which body has the AICPA designated as having the authority to set accounting standards under the Accounting Principles Rule (in ET 1.320 and 2.320 of the Code)? Include relevant excerpts from Appendix A to support your response.
2. Scan Part 3 of the Code. To whom is this section applicable, and what is the primary focus of this section?
3. List three examples of individuals who are considered "covered members" in the Code's definitions section.
4. Should a member in business allow *pressure from others* to result in a breach of the Integrity and Objectivity rule?
5. What are the two broad categories of safeguards identified in Part 2 of the Code, in the Conceptual Framework for members in business?
6. Provide the Code reference to the rule that governs "acts discreditable" for "members in public practice."
7. Alex, a retired CPA, neglected to file his tax return this year. What does the Code say about this?
8. Using the definitions section of the Code, locate an example of information that is not considered *confidential client information*.
9. Jenny is a volunteer Board member for the animal shelter. Which part of the Code should she apply in performing these volunteer duties?

Auditing Standards (and Related Topics) Exercises

10. Consider AICPA guidance. What are three risk assessment procedures an auditor should undertake in order to assess an entity's risks of material misstatement in an audit?
11. Consider AICPA guidance. What steps should an auditor take if an auditor is unable to continue an engagement due to the discovery of fraud?
12. Does accepting contingent fees impair an auditor's independence? Use the PCAOB website to respond.
13. According to PCAOB standards, who is responsible for supervising an engagement and responsible for its performance?
14. What PCAOB auditing standard requires auditors to discuss critical audit matters in the audit report?
15. Go to the PCAOB's website and list one proposed audit standard named on the site. Where did you navigate within the site to find this?
16. Locate a PCAOB Staff Audit Practice Alert. Briefly, summarize the main issue addressed in this particular alert. Next, describe the role you think these alerts play in establishing auditing requirements for registered public accounting firms.
17. Under "Inspections" on the PCAOB's website, locate the link to Firm Inspection Reports. Review a firm inspection report and describe some of the findings (or deficiencies) cited by the PCAOB. In particular, look for firm inspection reports that say: "QC criticisms are now public."

Because the GASB Codification contains guidance with varying degrees of authority (recall the hierarchy of authoritative guidance), each paragraph within the Codification indicates its source material. This is also helpful to researchers looking for background information that is included within original standards, but which has not been included within the Codification. Also, where relevant, topics link to separately located content such as Implementation Guides and certain AICPA content. Certain topics also include paragraphs .901–.999, Nonauthoritative Discussion.

To illustrate the format of an individual topic, Figure 10-6 depicts the top-of-page matter for Topic A10 (Certain Asset Retirement Obligations). Notice that the page lists the topic's source material ("Sources") and provides links to related topics (under "See Also").



Reproduced with permission of the Financial Accounting Foundation.

Figure 10-6

Sample GASB Codification section, A10 (Certain Asset Retirement Obligations), blue circles added

Considering Figure 10-6, respond to the following.

Now YOU Try 10.7

1. What are some sources used to generate this Codification topic ~~Pe50~~? Why might a researcher want to review these source materials?

2. What are the two related topics listed next to "See Also"?

A few additional observations regarding Figure 10-6: Notice that the list of "Open Documents" on the left side of the screen keeps a running list of any documents a researcher views. Click two of the checkboxes, and you'll have the option to view two documents concurrently. Additionally, researchers can use the "See Also" links for additional direction if an initial search proves fruitless.

TIP from the Trenches

When researching an issue that is new to you, chances are pretty good that you won't always end up in the right place the first time. Take advantage of the "See Also" links within each standard to generate ideas about possible other, or related, areas to search for relevant guidance.

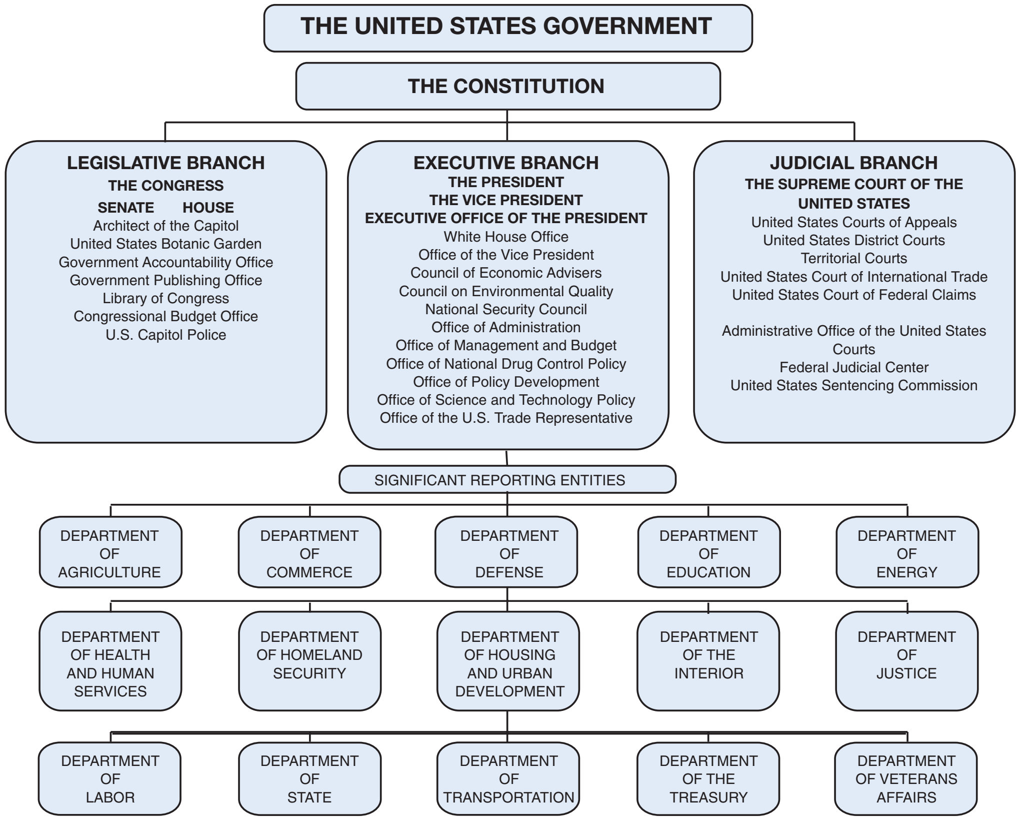


Figure 10-11

Organization of the U.S. government, including "significant" executive branch reporting entities required to prepare audited financial statements

The FASAB was established in 1990 in order to create accounting standards for the financial reports required under the CFO Act. Federal officials representing the Department of the Treasury and the Office of Management and Budget (OMB), both Executive Branch entities, and the Government Accountability Office (GAO), a legislative branch agency—having the authority to set these standards—created the FASAB and delegated to it their standard setting responsibilities.

Collectively, the Department of Treasury, the OMB, and the GAO (i.e., the **sponsor agencies**) fund the FASAB. Of the FASAB's nine-member board, three members are appointed by the sponsor agencies, and six members are selected from the public. Two of the FASAB's sponsor agencies, the GAO and OMB, have the right to review and, at their discretion, object to, FASAB standards before they are issued as final.

Now YOU Try 10.8

1. Within Figure 10-11, locate the FASAB's three *sponsor agencies* and circle them.
2. Considering the *significant reporting entities* depicted in Figure 10-12, which entities' financial statements would you be most interested in reviewing? Why?

3. What perspectives or priorities might you expect members appointed by the GAO and OMB to bring to the FASAB board? Explain.

In the auditor's (or attestation provider's) report, when stating that an engagement was performed in accordance with GAGAS, it is not necessary to state that the engagement also complied with AICPA standards. Because GAGAS incorporates AICPA standards by reference, it is understood that an engagement performed in accordance with GAGAS also complies with AICPA standards.[14]

Following is a brief **Now YOU Try** exercise intended to reinforce the sources of guidance that must be followed under GAGAS.

Understanding Compliance with GAGAS

Now YOU Try 10.11

Review the excerpt from **par. 6.01** and **6.02** and the preceding discussion, and respond to the following.

1. For an auditor to comply with GAGAS, he or she must also comply with the AICPA's ______________________________ .
2. Specifically, an auditor must comply with all sections of the AICPA's SAS, including the introduction, objectives, ______________________________ .
3. When citing compliance with GAGAS in the auditor's report, it is not necessary to also state that the audit complied with AICPA standards because ______________________________

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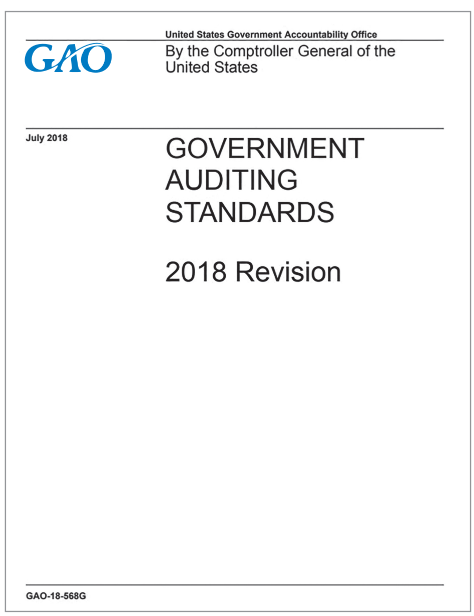
The Yellow Book is accessible on the GAO's website at www.gao.gov/yellowbook. Figure 10-17 illustrates the cover page of the Yellow Book.

Within the Yellow Book, guidance is organized by topic. Therefore, when searching for guidance, researchers may find it most efficient to scan the Yellow Book's table of contents. This offers researchers the benefit of getting a feel for available guidance and seeing how it is organized. Alternatively, researchers can perform keyword searches of the entire document, using ctrl + f.


GAO
United States Government Accountability Office
By the Comptroller General of the United States

July 2018

GOVERNMENT AUDITING STANDARDS

2018 Revision

GAO-18-568G

Figure 10-17
GAO's *Government Auditing Standards* (Yellow Book) cover page

Figure 10-18 lists the chapters and summarizes some of the key content included in the Yellow Book.

[14] GAO, *Government Auditing Standards* (i.e., the "Yellow Book"). 2018 Revision. Chapter 6, par. 6.37.

Continued from previous page

- reasonably estimate or adequately support amounts reported for certain liabilities, such as environmental and disposal liabilities, or determine whether commitments and contingencies were complete and properly reported;
- support significant portions of the reported total net cost of operations, most notably related to DOD, and adequately reconcile disbursement activity at certain federal entities;
- adequately account for and reconcile intragovernmental activity and balances between federal entities;
- reasonably assure that the consolidated financial statements are (1) consistent with the underlying audited entities' financial statements, (2) properly balanced, and (3) in accordance with [GAAP]; . . .

Questions:

1. According to par. 6.40 of the Yellow Book, when must auditors report on internal controls over financial reporting?

____

2. What reasons does the GAO give for its disclaimer of opinion?

____

____

3. Describe how the GAO's audit report excerpt satisfies the requirements in par. 6.50 of the Yellow Book~~ and identify any areas not shown in this particular excerpt that are also required by par. 6.50~~.

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APPENDIX 10A: APPLYING THE GASB CODIFICATION, AN EXTENDED EXAMPLE

Recognition of Tax Revenues, Using Fund Accounting

The following example illustrates the recognition of sales and property tax revenues by a local government. In doing so, the example touches on the different bases of accounting applicable to governments (accrual and modified accrual), as well as the use of fund accounting. For teaching purposes, this example has been kept very simple; however, in practice, these issues can be much more nuanced and can require professional judgment and as necessary, additional research.

Facts: Assume that the Town of Hampton imposes two taxes on its residents:

1. A 10 cents per-gallon fuel tax, charged on purchases of gasoline from gas stations located in the town.
2. A 2% property tax, charged annually on the assessed value of residential properties. This tax is billed in January of each year; collections generally occur within 15 to 30 days.

Respond to the questions that follow using the guidance provided.

Exercises Requiring Access to eIFRS

Note: You may have to log out of your "free" eIFRS Basic access in order to use your more advanced IAAER-sponsored eIFRS access.

13. What are the three criteria for recognition of a provision?
14. ~~Refer to the Blue Book's introductory material. What are two objectives of the IASB? Can this same information be found in the introductory material to the Red Book as well?~~
15. Locate discussion of how the IASB considered differences between the terms *exit price* and an *exchange amount* in establishing principles for fair value measurement. Are these concepts considered to be similar? Consider discussion in the IASB's basis for conclusions.
16. How should exploration and evaluation assets be measured? What are these?
17. How should cash repayments of amounts borrowed be classified in the statement of cash flows?
18. What are the two recognition criteria for an Investment Property?

CASE STUDY QUESTIONS

Presto's Subsidiaries Presto Hospitality is based in the United States and has subsidiaries in Brazil and Australia. As a nonpublic company with a calendar year-end, Presto is required to comply with ASC 842 for its consolidated financial statements starting with the year ending 12/31/20. 12.1

1. Research the reporting framework applicable to the Brazil- and Australia-based subsidiaries. Assume they follow the same reporting framework that listed (or public) companies in their jurisdictions would apply.
2. What is the effective date for these subsidiaries to apply revised lease accounting requirements? What standard must each apply?
3. What are key areas of reconciliation that will be required to consolidate the Brazilian and Australian financial statements into the U.S. consolidated report?

Remediation Required A Brazilian listed entity, Company B, violated environmental regulations by seeping hazardous chemicals from its production plant into a nearby pond. As of 12/31/X1, government regulators are aware of the pollution and plan to take action against the company. Company B anticipates that this action will include fines, plus a requirement to remediate the pollution. What disclosure or accruals are required by Company B? How would this accounting differ if Company B were subject to U.S. GAAP? 12.2

Boom Town Presto's Brazilian Subsidiary, BrazilCo, owns a corporate office in a desirable location in downtown Brasilia. The property was purchased on 1/1/20X1 for the equivalent of $10 million USD and is being depreciated straight-line over a 30-year life. An appraisal on 12/31/X4 indicated that the building is now worth $14 million. BrazilCo is asking whether it can remeasure the property to show this increased value on its statement of financial position and, if so, what the offsetting (credit) entry should be. BrazilCo is also asking whether this remeasurement would have any effect on its existing policy to depreciate the building straight-line over 30 years. Finally, Presto is wondering whether this increased value is appropriate to carry into its U.S. consolidated financial statements. 12.3

IFRS for SMEs Assume that BrazilCo's Controller (from the previous case study) has asked whether revaluation of the building is appropriate assuming BrazilCo had applied *IFRS for SMEs* (assuming the company was permitted to apply this guidance). Draft a brief email to the company's Controller explaining the different accounting, and cite your source. 12.4

BrazilCo's Restaurant Lease On 1/1/X1, Presto's Brazilian subsidiary, BrazilCo, leases a vacant restaurant in Brasilia for a 5-year term with fixed payments amounting to the equivalent of $100,000 USD per year in year 1, $150,000 in years 2 and 3, and $200,000 in years 4 and 5. BrazilCo's incremental borrowing rate is 6%. Assume the restaurant's useful life is 20 years. 12.5

a. Describe the classification of this lease on BrazilCo's subsidiary-level financial statements.

b. Show how this lease would be initially reported on the balance sheet, and show how the lease would flow through the income statement on 12/31/X1 and 12/31/X2 in BrazilCo's subsidiary-level financial statements.

c. Next, identify differences in this reporting compared to U.S. GAAP, as Presto will need to reconcile this reporting to GAAP for its consolidated financial statements.

Tell only true stories that come from your own experience or from reliable sources (such as a trusted news source). Don't tell a story that could jeopardize your credibility with your audience!

Another aspect of making content resonate is that it should be *tailored to your audience*. Don't present the broad, boilerplate requirements of a new accounting standard to a client whose adoption of the guidance is already well under way. Rather, perhaps a presentation on "common implementation issues our national office has consulted on" would be more meaningful.

Finally, if you are presenting to a classroom of your peers, a key goal of your presentation should always be to *teach your peers*. Act as though your peers will be tested on the information you are presenting, and make the concepts as understandable as you can. According to one field test, students' test results improved once their peers focused on *teaching* as a key goal of their presentations.[1] With this goal in mind, you should take creative license to present in a way that reaches your peers.

Now YOU Try 13.3

1. In what circumstances would you imagine that a picture or timeline could assist in presenting the facts or background of a transaction?

____

____

2. Where (or how) might you look for examples from practice that illustrate the concepts involved in your case?

____

____

How Much Detail Should I Include in My Slides?

The amount of detail you include in your slides will be driven primarily by the size of your audience, and by your firm's existing practices.

Picture yourself sitting in an audit committee meeting, around a table. Your audience is somewhere between 6 and 25 people. Each person at the table has a copy of the slide deck, and critical accounting judgments are being discussed. The people at the table need enough detail that they can choose to agree or disagree with the accounting judgments at hand.

In this case, the level of detail depicted in the sample slide in Figure 13-1 might be appropriate. In this slide, the presenter is sharing a key excerpt from the guidance that will help the audit committee members assess the reasonableness of the judgment regarding whether concession licenses involve *identified assets*. The presenter has highlighted in bold the words from the excerpt that he believes are most critical to the analysis.

Figure 13-1

Sample level of detail appropriate when slides are distributed and discussed in a small-group setting

Are Concession Facilities "Identified Assets"?

>>> Portions of Assets

15-16 **A capacity portion of an asset is an identified asset if it is physically distinct** (for example, a floor of a building or a segment of a pipeline that connects a single customer to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. [Emphasis added]

Our Analysis: Fixed-location concession stands are identified assets; however, portable carts and the rights for vendors to hawk are not.

Source: ASC $\boxed{842\text{-}10}$

[1] Alford, DiMattia, Hill, & Stevens. 2011. A Series of Revenue Recognition Research Cases Using the Codification. *Issues in Accounting Education* 26 (3): 618.