Financial Accounting Theory and Analysis - Text and Cases 15th edition Schroeder Solutions Manual

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Accounting Theory and Analysis

15th Edition

FASB ASC Tutorial and Solutions Manual

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Using the Codification to Solve the FASB ASC Cases

Prior to attempting to use the codification website to solve the FASB ASC cases, it is recommended that you read "Test Driving the Codification," by Carolyn Ford and C. William Thomas, *Journal of Accountancy*, December, 2008. Available at http://www.journalofaccountancy.com/Issues/2008/Dec/TestDrivingtheCodification.htm and review the tutorials on the codification website.

Overview of the Codification

The Financial Accounting Standards Board codification (FASB ASC) is organized into general topics listed on the left-hand side of the home page (General Principles, Presentation, etc.). Clicking on any of the general topics will bring up what the FASB terms a "landing page." Each landing page contains a list of subtopics for that link. For example, clicking on the general topic Assets brings up list of seven subtopics (Cash and Cash Equivalents, Receivables, etc.). Notice that each of the subtopics is identified by a three-digit number. This allows for access via the go to function that we will discuss later.

Clicking on any of the subtopics brings up a second link to what are termed sections and contain the content specific area of the FASB ASC. All Subtopics have a set of standard Sections unless there is nothing to include in a particular standard section, in which case that standard Section is left out of the Subtopic and therefore the FASB ASC. There are sixteen standard Sections for each Subtopic. Sections are indicated by a two-digit number between 00 and 99. Some of the most frequently used sections are: 25 Recognition, 30 Initial Measurement 35 Subsequent Measurement, 50 Disclosure and Implementation Guidance and Instructions.

Each Section has Paragraph numbers that start over at the beginning of each Section. Each Paragraph, therefore, has a two-part number. The first number is the Section number, and the second part is the Paragraph number within that Section. The Paragraphs are where "substantive content" of the FASB ASC is found. The rest of the levels only exist to organize the information in the Paragraphs and help navigate to the information contained in them. In order to view the specific content areas, it is necessary to click on the JOIN ALL SECTIONS tab found on each section page. For example, assume we are interested in the authoritative literature on accounting for sales of products when a right to return exists. First, click on the topic Revenue at the left-hand side of the home page, then on the landing page Revenue Recognition. Next, click on the products subsection. Finally click the JOIN ALL SECTIONS tab and all of the paragraph content will appear. Page down through the material and you will find that Paragraph 25-1 contains the authoritative guidance for accounting for sales of products with a right to return.

The home page also gives other options for navigating the FASB ASC. Two of these are the SEARCH function and the GO TO option. We have found that using these

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functions is an easy way to start navigating the FASB ASC. To use the search method of navigating the FASB ASC, first, type the general topic in the search box at the top right of the FASB ASC home page. This will give you some references to specific FASB ASC sections where the topic is discussed.

Choose the section that seems most appropriate and type the reference number in the GO TO box at the top left-hand side of the FASB ASC homepage. Once you are redirected to the desired section, click combine sections and all of the information on the topic will be displayed. You can then browse through the material to find the appropriate subsection that addresses the case issue. Let's use this option to find the authoritative literature on accounting for sales of products with a right to return Type "right to return," in the search box at the top right of the FASB ASC web page. You will get references to the place where this issue is discussed. Seven possibilities appear, but in reviewing we see that the criteria are contained in 605-15-25-1. Type this number in the box next to the GO TO link at the top left-hand side of the FASB ASC homepage. This will redirect you to the content specific paragraph that discusses accounting for sales of products where a right of return exists. (Note: in some searches you may be redirected to the section outline. If so, click the JOIN ALL SECTIONS tab and all of the paragraph content will appear.

If the issue involves accessing a previous specific pronouncement, it is also possible to access the topic through the cross-reference function. On the home page, select Cross Reference. This feature allows you to access the relevant FASB ASC section by citing the original source. To use this feature, first access the drop-down menu under Standard Type. (Standard Type refers to the authoritative body that originally issued the pronouncement. For example, the Financial Accounting Standards Boards uses the acronym FAS. A discussion of the acronyms for the various standard types is contained through a link in the directions). Next, use the drop-down menu under standard number and choose the appropriate number. Then click GENERATE REPORT. When the results appear, click on the first paragraph number at the far-right side. Next, click on the 3-digit topic at the top under Table of Contents. When the results appear, click and expand and all of the subtopics will appear. Choose the subtopic you wish to view and then combine sections and the relevant authoritative literature will be displayed.

For example, to answer FASB ASC Case 9-3, choose FAS from the drop-down Standard Type menu. Then choose 143 from the standard number drop down menu**.** Click on GENERATE REPORT and when the results appear, click on 05-4 on the first line under paragraph number. When the results appear, click 410 Asset Retirement and Environmental Obligations. When the results appear, the most appropriate section

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seems to be 20 Asset Retirement Obligations. Select it and then click the JOIN ALL SECTIONS tab and all of the paragraph content will appear.

Finding original source material still contained in the Codification

Several of the FASB ASC cases ask for EITF pronouncements related to a particular topic. In order to find original source material from the EITF or any other authoritative body use the following steps:

1. Find the relevant topic in the FASB ASC
2. Click expand for the relevant subtopic
3. Click the JOIN ALL SECTIONS tab
4. From the **menu** **f Page/Print functions** **select Printer-friendly with sources**
5. Page through the material to find content originally sourced from the EITF

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CHAPTER 1

Case l-1

a. The FASB had three primary goals in developing the Codification:

1. Simplify user access by codifying all authoritative US GAAP in one spot.
2. Ensure that the codified content accurately represented authoritative US GAAP as of July1, 2009.
3. Create a codification research system that is up to date for the released results of standard-setting activity.

b. The Codification is expected to improve accounting practice by:

1. Reducing the amount of time and effort required to solve an accounting research issue
2. Mitigating the risk of noncompliance through improved usability of the literature
3. Provide accurate information with real-time updates as Accounting Standards Updates are released
4. Assisting the FASB with the research and convergence efforts.

c. The FASB ASC is composed of the following literature issued by various standard setters:

1. Financial Accounting Standards Board (FASB)
   a. Statements (FAS)
   b. Interpretations (FIN)
   c. Technical Bulletins (FTB)
   d. Staff Positions (FSP)
   e. Staff Implementation Guides (Q&A)
   f. Statement No. 138 Examples.
2. Emerging Issues Task Force (EITF)
   a. Abstracts
   b. Topic D.
3. Derivative Implementation Group (DIG) Issues
4. Accounting Principles Board (APB) Opinions
5. Accounting Research Bulletins (ARB)
6. Accounting Interpretations (AIN)
7. American Institute of Certified Public Accountants (AICPA)
   a. Statements of Position (SOP)
   b. Audit and Accounting Guides (AAG)—only incremental accounting guidance

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c. Practice Bulletins (PB), including the Notices to Practitioners elevated to Practice Bulletin status by Practice Bulletin 1
d. Technical Inquiry Service (TIS)—only for Software Revenue Recognition

Additionally, in an effort to increase the utility of the FASB ASC for public companies, relevant portions of authoritative content issued by the SEC and selected SEC staff interpretations and administrative guidance have been included for reference in the Codification, such as:

1. Regulation S-X (SX)
2. Financial Reporting Releases (FRR)/Accounting Series Releases (ASR)
3. Interpretive Releases (IR)
4. SEC Staff guidance in:
   i. Staff Accounting Bulletins (SAB)
   ii. EITF Topic D and SEC Staff Observer comments

d. The FASB ASC contains all current authoritative accounting literature. However, if the guidance for a particular transaction or event is not specified within it, the first source to consider is accounting principles for similar transactions or events within a source of authoritative GAAP. If no similar transactions are discovered, nonauthoritative guidance from other sources may be considered. Accounting and financial reporting practices not included in the Codification are nonauthoritative. Sources of nonauthoritative accounting guidance and literature include, for example, the following:

1. Practices that are widely recognized and prevalent either generally or in the industry
2. FASB Concepts Statements
3. American Institute of Certified Public Accountants (AICPA) Issues Papers
4. International Financial Reporting Standards of the International Accounting Standards Board Pronouncements of professional associations or regulatory agencies
5. Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids
6. Accounting textbooks, handbooks, and articles

Case 1-2

a. Subsequent to its formation, the SEC began reviewing the registrations required by the securities acts. Despite the absence of a body of well-established accounting principles, the SEC begin to challenge accounting practices they considered inaccurate or misleading and a recurring issue emerged. Many companies were increasing assets to

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current or appraisal value with commensurate increases in reserves or equity (surplus) accounts. Expenses that should have been charged against earnings were then offset against those surplus accounts. The SEC believed this practice was incorrect but the securities laws were disclosure laws. It questioned whether a presentation it believed to be wrong could be accepted if fully disclosed, particularly if the SEC had not previously stated that the practice was incorrect. That is, at what point do accounting presentations that are not correct, though disclosed, amount to violations of the security laws? Accounting Series Release No. 1 was issued in response to the appraisal value and other questionable accounting practices prevalent at that time. It stated that opinions on accounting principles would be published periodically for the purpose of contributing to the development of uniform standards and practices on major accounting questions and specifically stated that losses properly chargeable against income should not be charged against surplus.

b. At that time the SEC was engaged in an internal debate over whether it should develop accounting standards. In 1938, it decided in *Accounting Series Release No. 4* to allow accounting principles to be set in the private sector. This release stated that reports filed with the SEC must be prepared in accordance with accounting principles that have "substantial authoritative support." If financial statements were prepared in accordance with principles for which there was no substantial authoritative support, the SEC would presume that the statements were misleading or inaccurate, despite disclosures. If the SEC differed with a registrant on an accounting practice, disclosure in lieu of correction would be accepted only if there were substantial authoritative support for the registrant's practice.

Case 1-3

a. Inclusion or omission of information that materially affects net income harms particular stakeholders. Accountants must recognize that their decision to implement (or delay) reporting requirements will have immediate consequences for some stakeholders.

b. Yes. Because the FASB standard results in a fairer presentation, it should be implemented as soon as possible--regardless of its impact on net income.

c. The accountant's responsibility is to provide financial statements that present fairly the financial condition of the company. By advocating early implementation, Hoger fulfills this task.

d. Potential lenders and investors, who read the financial statement and rely on its fair representation of the financial condition of the company, have the most to gain by early implementation. A stockholder who is considering the sale of stock may be harmed by early implementation that lowers net income (and may lower the value of the stock).

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Case 1-4

a. CAP. The Committee on Accounting Procedure, CAP, which was in existence from 1939 to 1959, was a natural outgrowth of AICPA (then AIA) committees, which were in existence during the period 1933 to 1938. The committee was formed in direct response to the criticism received by the accounting profession during the financial crisis of 1929 and the years thereafter. The authorization to issue pronouncements on matters of accounting principles and procedures was based on the belief that the AICPA had the responsibility to establish practices that would become generally accepted by the profession and by corporate management.

As a general rule, the CAP directed its attention, almost entirely, to resolving specific accounting problems and topics rather than to the development of generally accepted accounting principles. The committee voted on the acceptance of specific Accounting Research Bulletins published by the committee. A two-thirds majority was required to issue a particular research bulletin. The CAP did not have the authority to require acceptance of the issued bulletins by the general membership of the AICPA but rather received its authority only upon general acceptance of the pronouncement by the members. That is, the bulletins set forth normative accounting procedures that "should be" followed by the accounting profession but were not "required" to be followed.

It was not until well after the demise of the CAP, in 1964, that the Council of the AICPA adopted recommendations that departures from effective CAP Bulletins should be disclosed in financial statements or in audit reports of members of the AICPA. The demise of the CAP could probably be traced by four distinct factors: (1) the narrow nature of the subjects covered by the bulletins issued by the CAP, (2) the lack of any theoretical groundwork in establishing the procedures presented in the bulletins, (3) the lack of any real authority by the CAP in prescribing adherence the procedures described by the bulletins, and (4) the lack of any formal representation on the CAP of interest groups such as corporate managers, governmental agencies, and security analysts.

APB. The objectives of the APB were formulated mainly to correct the deficiencies of the CAP as described above. The APB was thus charged with the responsibility of developing written expression of generally accepted accounting principles through consideration of the research done by other members of the AICPA in preparing Accounting Research Studies. The committee was in turn given substantial authoritative standing in that all opinions of the APB were to constitute substantial authoritative support for generally accepted accounting principles. If an individual member of the AICPA decided that a principle of procedure outside of the official pronouncements of the APB had substantial authoritative support, the member had to

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disclose the departure from the official APB opinion in the financial statements of the firm in question.

The membership of the committee comprising the APB was also extended to include representation from industry, government, and academe. The opinions were also designed to include minority dissents by members of the board. Exposure drafts of the proposed opinions were readily distributed.

The demise of the APB occurred primarily because the purposes for which it was created were not being accomplished. Broad generally accepted accounting principles were not being developed. The research studies supposedly being undertaken in support of subsequent opinions to be expressed by the APB were often ignored. The committee in essence became a simple extension of the original CAP in that only very specific problem areas were being addressed. Interest groups outside of the accounting profession questioned the appropriateness and desirability of having the AICPA directly responsible for the establishment of GAAP. Politicization of the establishment of GAAP had become a reality because of the far-reaching effects involved in the questions being resolved.

FASB. The formal organization of the FASB represents an attempt to vest the responsibility of establishing GAAP in an organization representing the diverse interest groups affected by the use of GAAP. The FASB is independent of the AICPA. It is independent, in fact, of any private or governmental organization. Individual CPAs, firms of CPAs, accounting educators, and representatives of private industry will now have an opportunity to make known their views to the FASB through their membership on the Board. Independence is facilitated through the funding of the organization and payment of the members of the Board. Full-time members are paid by the organization and the organization itself is funded solely through contributions. Thus, no one interest group has a vested interest in the FASB.

Conclusion. The evolution of the current FASB certainly does represent "increasing politicization of accounting standard setting." Many of the efforts extended by the AICPA can be directly attributed to the desire to satisfy the interests of many groups within our society. The FASB represents, perhaps, just another step in this evolutionary process.

b. Arguments for politicization of the accounting rule-making process:

1. Accounting depends in large part on public confidence for its success. Consequently, the critical issues are not solely technical, so all those having a bona fide interest in the output of accounting should have some influence on that output.

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2. There are numerous conflicts between the various interest groups. In the face of this, compromise is necessary, particularly since the critical issues in accounting are value judgments, not the type which are solvable, as we have traditionally assumed, using deterministic models. Only in this way (reasonable compromise) will the financial community have confidence in the fairness and objectivity of accounting rule making.

3. Over the years, accountants have been unable to establish, on the basis of technical accounting elements, rules which would bring about the desired uniformity and acceptability. This inability itself indicates rule setting is primarily consensual in nature.

4. The public accounting profession, through bodies such as the Accounting Principles Board, made rules which business enterprises and individuals "had" to follow. For many years, these businesses and individuals had little say as to what the rules would be, in spite of the fact that their economic well-being was influenced to a substantial degree by those rules. It is only natural that they would try to influence or control the factors that determine their economic well-being.

c. Arguments against the politicization of the accounting rule-making process:

1. Many accountants feel that accounting is primarily technical in nature. Consequently, they feel that substantive, basic research by objective, independent and fair-minded researchers ultimately will result in the best solutions to critical issues, such as the concepts of income and capital, even if it is accepted that there isn't necessarily a single "right" solution.

2. Even if it is accepted that there are no "absolute truths" as far as critical issues are concerned, many feel that professional accountants, taking into account the diverse interests of the various groups using accounting information, are in the best position, because of their independence, education, training, and objectivity, to decide what generally accepted accounting principles ought to be.

3. The complex situations that arise in the business world require that trained accountants develop the appropriate accounting principles.

4. The use of consensus to develop accounting principles would decrease the professional status of the accountant.

5 This approach would lead to "lobbying" by various parties to influence the establishment of accounting principles.

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Case 1-5

a. The term "accounting principles" in the auditor's report includes not only accounting principles but also\practices and the methods of applying them. Although the term quite naturally emphasizes the primary or fundamental character of some principles, it includes general rules adopted or professed as guides to action in practice. The term does not however, mean rules from which there can be no deviation. In some cases, the question is which of several partially relevant principles has determining applicability. Neither is the term "accounting principles" necessarily synonymous with accounting theory. Accounting theory is the broad area of inquiry devoted to the definition of objectives to be served by accounting, the development and elaboration of relevant concepts, the promotion of consistency through logic, the elimination of faulty reasoning, and the evaluation of accounting practice.

b. Generally accepted accounting principles are those principles (whether or not they have only limited usage) that have substantial authoritative support. Whether a given principle has authoritative support is a question of fact and a matter of judgment. Since September 15, 2009 the primary source of GAAP has been the FASB's accounting standards codification. However, if the guidance for a transaction or event is not specified within a source of authoritative GAAP for that entity, an entity shall first consider accounting principles for similar transactions or events within a source of authoritative GAAP for that entity and then consider nonauthoritative guidance from other sources (FASB ASC 105-10-5-2). The CPA is responsible for collecting the available evidence of authoritative support and judging whether it is sufficient to bring the practice within bounds of generally accepted accounting principle.

c. The auditor's report states that a company's financial statements present "fairly," in all material respects, its financial position, based on his or her judgment as to whether the accounting principles selected and applied have general acceptance and that the accounting principles selected are appropriate given the circumstances. This statement is necessary because there are many areas where companies make choices among and between accounting principles (Depreciation method, inventory cost flow assumptions, etc.). Therefore, it is expected that financial reports are prepared in a manner that reflects the underlying economic events and activities of the reporting entity. This expectation was stressed in *SAS No. 90* which stated, "In each SEC engagement, the auditor should discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles applied in its financial reporting. The discussion should also include items that have a significant impact on the representational faithfulness, verifiability, and neutrality of the accounting information included in the financial statements. "As a consequence, the choices of accounting principles made by one company are often different than those made by another company.

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Case 1-6

A factor that influenced the development of accounting during the 19th century was the evolution of joint ventures into business corporations in England. The fact that many individuals, external to the business, needed information about the corporation's activities created the necessity for periodic reports. Additionally, the emerging existence of corporations created the need to distinguish between capital and income.

The statutory establishment of corporations in England in 1845 stimulated the development of accounting standards, and laws were subsequently passed that were designed to safeguard shareholders against improper actions by corporate officers. Dividends were required to be paid from profits, and accounts were required to be kept and audited by persons other than the directors. However, initially anyone could claim to be an accountant, as there were no organized professions or standards of qualifications.

The industrial revolution and the succession of Companies Acts in England also served to increase the need for professional standards and accountants. In the later part of the 19th century, the industrial revolution arrived in the United States, and with it came the need for more formal accounting procedures and standards. This period was also characterized by widespread speculation in the securities markets, watered stocks, and large monopolies that controlled segments of the United States economy.

In the 19th century the progressive movement was established in the United States, and in 1898 the Industrial Commission was formed to investigate and report on questions relating to immigration, labor, agriculture, manufacturing, and business. Although no accountants were either on the Commission or used by the Commission, a preliminary report issued in 1900 suggested that an independent public accounting profession should be established in order to curtail observed corporate abuses.

Although most accountants did not necessarily subscribe to the desirability of the progressive reforms, the progressive movement conferred specific social obligations on accountants. As a consequence accountants generally came to accept three general levels of progressiveness: (1) a fundamental faith in democracy, a concern for morality and justice and a broad acceptance of the efficiency of education as a major tool in social amelioration; (2) an increased awareness of the social obligation of all segments of society and introduction of the idea of accountability to the public of business and political leaders; and (3) an acceptance of pragmatism as the most relevant operative philosophy of the day.

The major concern of accounting during the early 1900s was the development of a theory that could cope with corporate abuses that were occurring at that time, and capital maintenance emerged as a concept. This concept evolved from maintaining invested capital intact, to the maintenance of the physical productive capacity of the firm, to the maintenance of real capital. In essence this last view of capital maintenance was an extension of the economic concept of

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