

## Case 12-6

### Philadelphia Communications

You are a summer intern working on the audit of the Philadelphia Communications Inc. (Philly). Philly is a public company that completed an initial public offering (IPO) a few months ago. Decedents of the founding family headed by John Sigar, the eldest grandchild and current CEO of the company, still own a significant amount of the company's stock. Mr. Sigar as CEO and member of the board of directors is the only family member still involved in the business.

You have been assigned to help test accounts receivable. Specifically, you are going to test receivables from shareholders. It is your first time doing audit testing, so you have been reviewing the prior year's audit working papers to make sure you understand how things work. There are a number of notes receivable from several of Mr. Sigar's cousins. They have taken advances frequently over the years and have never failed to repay notes when they came due. These notes are secured by shares of Philly's convertible preferred stock purchased by the family members following the IPO. The receivable support provided by the client does not specify interest or payment terms for these notes.

You remember from your first semester in intermediate accounting that there are some special presentation or classification issues regarding these sorts of receivables. You understand the family members are considered "related parties" and there are some extra disclosures required as a result. You are also pretty sure there is something else that is key here, but you cannot quite put your finger on it.

You have reviewed your old notes on revenue recognition since that is a big part of auditing receivables. You have also looked over Chapter 7 of your old "Kieso" textbook, but there is nothing included on this sort of situation. There is nothing in Philly's audit papers from last year because this is the first year the family members have borrowed from Philly in the form of secured notes. You do not think collectibility is an issue primarily because (1) the Sigars are very wealthy and (2) the preferred stock that secures the notes is worth a good deal more than the amounts due.

#### Required:

1. Complete your preparation to test accounts receivable by reviewing the *FASB Accounting Standards Codification* and identify any special presentation or disclosure issues applicable to the above described situation. Be prepared to discuss the following:
  - a. Applicable Codification references.
  - b. Related presentation and disclosure issues for the notes.
  - c. Any additional clarifying information needed from company management.
2. In anticipation of a follow-up question from the engagement partner (who happens to be the local office "expert" on IFRSs), what guidance can you find to address this situation from an international accounting standpoint?