

# **SOLVING THE MYSTERY OF COST: AN ANALYSIS OF THE FUTURE VALUE OF THE COST OF DISCOVERY**

*Kamal Haddad, Professor of Finance  
Feraidoon (Fred) Raafat, Professor of Operations and Supply Chain Management  
James E. Williamson, Professor of Accounting  
College of Business Administration, San Diego State University,  
San Diego, CA 92182-8236 USA*

## **ABSTRACT**

One of the more perplexing issues in measurement and forecasting models is the uncertainty concerning future events. Indeed, this uncertainty has been the basis for the development of enumerable models, especially those that attempt to measure future revenues. One area that has not been fully explored, however, is the value that current research efforts provide to future research efforts because the current research provides a platform already developed from which the future efforts can take off. This topic has largely been neglected in the past, probably because it has been viewed as too conceptually vague to grasp and too difficult to measure. There is no doubt, however, that all future research does benefit from successful prior research that provides useful additions to the body of knowledge that provide a new advanced starting point for the future research.

For example, Charlie Jones, CPA, has just finished a tax research project for a client who had received a \$40,000,000 deficiency notice from the Internal Revenue Service. After accepting the engagement at an agreed billing rate of \$500 per hour, Jones spent 1,000 hours on research and preparation of the client's response to the IRS. The disputed issues were successfully resolved for the client with the deficiency notice being reduced to zero. Thereupon, Jones submitted a bill to the Client for \$500,000 and, subsequently, received that amount as a professional fee for his effort. Shortly thereafter, a prospective new client approached Jones with a large deficiency notice from the IRS concerning exactly the same issues. Obviously, Jones will take the engagement because he now knows how to successfully defend the client and has already done the necessary legal research. The problem that Jones faces is determining the amount that the new client should be billed for this engagement.

This becomes extremely complicated, because, if the second client had come in first, he would have been billed \$500,000. Just because of the matter of timing, or luck, should he pay little or nothing and the first client pay everything? Or should the second client also pay \$500,000 because the market for these services just recently had determined that was a fair price? What would Jones have done differently if the first client had not been billed before the second client engagement was completed?

This paper will explore several of the issues concerning the future value of the cost of discovery. The term discovery is used rather than research and development (R&D), to indicate that the issues related to discovery are much more than the just the issues of R&D. In addition to an analysis of analytical measurement feasibility, it will be necessary to consider major ethical issues.

A major objective of the paper is to determine whether the future value of the cost of discovery can be added to existing measurement and forecasting models such as the capital budgeting models, activity based costing models (ABC), capacity planning models, etc.