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A COMPILATION OF ACCOUNTING CASE STUDIES

by
Forbes Owen

A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements of the Sally McDonnell Barksdale Honors College.

Oxford
May 2018

Approved by:

____
Advisor: Professor Victoria Dickinson

____
Second Reader: Dean Mark Wilder

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To my family; John, Charlotte, and Benton. I would not be the woman I am today without each of you. Thank you for always supporting and loving me unconditionally.

ABSTRACT

ELIZABETH FORBES OWEN: A Compilation of Accounting Case Studies
(Under the direction of Victoria Dickinson)

This thesis has been prepared to meet requirements for the Sally McDonnell Barksdale Honors College in alliance with The Patterson School of Accountancy. Throughout the course of a year, I studied and researched various topics within the world of accounting and business. This thesis serves as a compilation of each of those cases. Topics vary from issues dealing with inventory, revenue, and depreciation to sifting through the FASB's Codification to support client requests. Each case presents a new topic within accounting with support for the given question or issues the client presented. At the end of each case, an outcome has been reached that aided the client. Research has been presented through executive summaries, journal entries, data analysis, and financial statement comparisons.

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Case 1: Financial Statement Analysis
GLENWOOD HEATING, INC. & EADS HEATER, INC.
FINANCIAL ANALYSIS

Executive Summary:

During 20X1 Eads Heater, Inc. and Glenwood Heating, Inc. opened their doors for business and served the Eads and Glenwood Springs, Colorado areas. Both companies service their respective Colorado areas by selling home heating units. Each business takes some liberty in the way they apply generally accepted accounting principles (GAAP) while creating their financial statements. Over the course of a few weeks, my team and I sifted through each company's first-year transactions, prepared journal entries for each event, and developed both unadjusted and adjusted trial balances. These ultimately helped me create a multistep income statement, statement of changes in stockholder's equity, classified balance sheet, and a statement of cash flows. Through my examination and work with each company, I was able to come up with my own analysis that will later be presented after a thorough examination of each company's financial statements. The following report presents a detailed analysis of my findings and evaluation of each company's operations during 20X1. Methods of my analysis include breaking down each company's financial statements and illustrating the events which connect each company's trial balances and financial statements. During their first year of business both companies had identical transactional events but each company took different approaches with their adjustments at the close of the year.

Financial Performance: Glenwood Heating, Inc.

The following four financial statements were created during year 20X1 for Glenwood Heating. After reviewing these informational statements, one can tell that Glenwood Heating's first year of operation has been quite successful. They managed to make a nice profit for their company, as well as distribute dividends to their investors. After examining the following statements one should be able to see Glenwood's first year success. This company is definitely going to be one that competitors, as well as investors, in the home heating unit business should keep an eye on in the near future.

Glenwood Heating Inc. Statement of Changes in Stockholder's Equity For the Year End 12/31/20X1			
	Common Stock	Retained Earnings	Total Stockholder's Equity
Balances 1/1/20X1	-	-	-
Issued shares	160,000.00		160,000.00
Net Income		92,742.00	92,742.00
Dividends		23,200.00	23,200.00
Balance 12/31/20X1	**160,000.00**	**69,542.00**	**229,542.00**

Glenwood Heating Inc			
Balance Sheet			
12/31/20X1			
Assets		**Liabilties**	
Current Assets		Accounts Payable	26,440.00
Cash	426.00	Interest Payable	6,650.00
Accounts Receivable	99,400.00	Notes Payable	380,000.00
Allowance for Bad Debt	- 994.00	Lease Payable	-
Inventory	62,800.00	Total Liabilies	413,090.00
Total Current Assets	161,632.00		
		Stockholder's Equity	
Non-Current Assets		Common Stock	160,000.00
Land	70,000.00	Retained Earnings	69,542.00
Building	350,000.00	Total Equity	229,542.00
Accumulated Depreciation-Building	- 10,000.00		
Equipment	80,000.00	**Total Liabilties and Equity**	**642,632.00**
Accumulated Depreciation-Equipment	- 9,000.00		
Leased Equipment	-		
Accumulated Depreciation-Leased Equipment	-		
Total Non-Current Assets	481,000.00		
Total Assets	**642,632.00**		

Glenwood Heating Inc		
Statement of Cash Flow		
For the Year End 12/31/20X1		
Operating Activies		
Net Income		92,742.00
Adjustments to Reconcile Net Income		
Depreciation Expense	19,000.00	
Increase in Accounts Receivable	- 99,400.00	
Increase Allowance for Bad Debt	994.00	
Decrease in Inventory	- 62,800.00	
Increase in Accounts Payable	26,440.00	
Interest Payable	6,650.00	
Cash Flow from Operating		- 16,374.00
Investing Activities		
Purchase of Building	- 350,000.00	
Purchase of Land	- 70,000.00	
Purchase of Equipment	- 80,000.00	
Cash Flows from Investing		- 500,000.00
Financing Activities		
Line of Credit(Notes)	380,000.00	
Sale of Common Stock	160,000.00	
Dividends	- 23,200.00	
Cash From Financing		516,800.00
Beginning Cash Balance		0
Net Cash Flow		426.00
End Cash Balance		**426.00**

<u>Financial Performance:</u> Eads Heater, Inc.

The following financial statements illustrate Eads Heater's actions during year 20X1. Eads is definitely off to a good start for their first year of operation. Eads' cost of goods sold is about $11,000 higher therefore giving Eads a lower gross profit than Glenwood. Eads has less operating expenses than Glenwood which in turn gives them a higher operating income. However, Eads has higher values for bad debt, depreciation expense, and interest expense than Glenwood which gives them a higher cost for non-operating expenses and a lower net income by about twenty-two thousand dollars.

Eads Heater Inc Net Income Statement For the Year End 12/31/20X1		
Revenue		398,500.00
Cost of Goods Sold		188,800.00
Gross Profit		209,700.00
Operating Expenses		
Other Operating Expenses	34,200.00	
Operating Income		175,500.00
Non-Operating Expenses		
Bad Debt Expense	4,970.00	
Depreciation Expense	41,500.00	
Interest Expense	35,010.00	
Provisions for Income taxes	23,505.00	104,985.00
Net Income		**70,515.00**

Eads Heater Inc. Statement of Changes in Stockholder's Equity For the Year End 12/31/20X1	Common Stock	Retained Earnings	Total Stockholder's Equity
Balances 1/1/20X1	-	-	-
Issued shares	160,000.00		160,000.00
Net Income		70,515.00	70,515.00
Dividends		- 23,200.00	- 23,200.00
Balance 12/31/20X1	**160,000.00**	**47,315.00**	**253,715.00**

Eads Heater Inc					
Classified Balance Sheet					
12/31/20X1					
Assets			**Liabilties**		
Current Assets			Accounts Payable		26,440.00
Cash		7,835.00	Interest Payble		6,650.00
Accounts Receivable		99,400.00	Notes Payable		380,000.00
Allowance for Bad Debt	-	4,970.00	Lease Payable		83,360.00
Inventory		51,000.00	Total Liabilties		496,450.00
Total Current Assets		153,265.00			
			Stockholder's Equity		
Non-Current Assets			Common Stock		160,000.00
Land		70,000.00	Retained Earnings		47,315.00
Building		350,000.00	Total Equity		207,315.00
Accumulated Depreciation-Building	-	10,000.00			
Equipment		80,000.00	**Total Liabilities and Equity**		**703,765.00**
Accumulated Depreciation-Equipment	-	20,000.00			
Leased Equipment		92,000.00			
Accumulated Depreciation-Leased Equipment	-	11,500.00			
Total Non-Current Assets		550,500.00			
Total Assets		**703,765.00**			

Eads Heater Inc.		
Statement of Cash Flow		
For the Year End 12/31/20X1		
Operating Activies		
Net Income		70,515.00
Adjustments to Reconcile Net Income		
Depreciation Expense	41,500.00	
Increase in Accounts Receivable	- 99,400.00	
Increase Allowance for Bad Debt	4,970.00	
Decrease in Inventory	- 51,000.00	
Increase in Accounts Payable	26,440.00	
Interest Payable	6,650.00	
Cash Flow from Operating		- 325.00
Investing Activities		
Purchase of Building	- 350,000.00	
Purchase of Land	- 70,000.00	
Purchase of Equipment	- 80,000.00	
Cash Flows from Investing		- 500,000.00
Financing Activities		
Line of Credit(Notes)	380,000.00	
Sale of Common Stock	160,000.00	
Dividends	- 23,200.00	
Payment on Capital Lease	- 8,640.00	
Cash From Financing		508,160.00
Beginning Cash Balance		0
Net Cash Flow		7,835.00
End Cash Balance		**7,835.00**

Analysis:

Upon reviewing and comparing Glenwood Heating, Inc. and Eads Heater, Inc., I have chosen to recommend stakeholders to invest in Glenwood Heating. At first glance, one can see that Glenwood has a higher net income by roughly twenty-two thousand dollars. Each company's statement of changes in stockholder's equity discloses significant information about equity that is not presented separately in the financial statements and can therefore be useful in understanding the nature of change in equity reserves. Because both companies had just begun business, their beginning balances were all zero. Each company's statement of changes in stockholder's equity is a much more consolidated version because neither had preferred stock, additional paid in capital, foreign currency translation adjustment, or treasury stock. At first glance, Eads appears to be better off. While both have the same value for common stock, Eads' total stockholder's equity value is roughly twenty-four thousand dollars higher than Glenwood's. However, Glenwood has a higher value for their ending retained earnings illustrating how they have reinvested or retained profits in their company for the year.

Next, I compared the two balance sheets for each company. Eads has higher values for their total assets, liabilities, and equity by roughly sixty-six thousand dollars. However, Glenwood has higher values for their total current assets and total equity. The differing ways in which each company dealt with their equipment leases illustrated why Eads' balance sheet totals were increased by about eighty thousand dollars. Glenwood recognized their equipment for the year as a rental while Eads treated their equipment as a capital lease agreement.

Finally, I analyzed and compared each company's statement of cash flow which illustrates how each company is spending their money and where their money originates. This information proves to be very valuable to investors because it offers good insight to what the company is doing throughout the year with their cash. Both companies have negative values for their cash from operating and investing. Eads' ending cash balance was about seven thousand dollars more than Glenwood's ending balance. As an investor for Glenwood, this difference in ending cash is nothing to be alarmed by because this was the first year for business and their other financial statements have positive, solid numbers which can be trusted to only help better the company in the coming years.

After compiling all of my data, I calculated a few more ratios for both companies in order to properly compare the two. While each financial statement can illustrate a useful picture of what is going on with each company, I found that calculating the following ratios proved to be more helpful. The first ratio I calculated was earnings per share (EPS) which serves as an indicator of a company's profitability. Eads' EPS was $0.44 and Glenwood's was $0.58. These numbers indicate that Glenwood's investors are earning slightly more per share. While these values are relatively close this year, in coming years the gap could widen between the two if Glenwood continues to be relatively more successful than Eads. The next ratio I calculated was inventory turnover in order to show how quickly each company was turning around their home heating units. Eads' inventory turnover ratio was 7.14 days and Glenwood's was 6.34 days. These numbers are extremely close, but once more Glenwood has slightly surpassed Eads by about one day. Perhaps investors would be best to revisit this number after a couple of years have gone by in order to have the best visual of how each company is turning

around their inventory. The final ratio I decided to calculate for the two companies was the times-interest-earned ratio which measures the extent to which operating income can decline before each firm is unable to meet its annual interest costs. I calculated each company's earnings before interest and taxes by subtracting depreciation and bad debt expense from operating income and then dividing that value by each company's interest charge. Eads Heater's ratio was 3.69 and Glenwood's was 5.47. Glenwood's higher times-interest-earned ratio indicates the company's ability to pay their interest expense with its before tax income roughly five times. While Eads' times-interest-earned ratio indicates they can do the same but only three times. Investors are going to be more inclined to invest in the less risky company, Glenwood. Eads' ratio is nothing to fully scare off investors. People are going to be more reluctant to invest when Glenwood has the ability to repay their interest nearly two times more and therefore be less volatile. Given the information at hand for year 20X1, Glenwood surpasses Eads in a number of comparisons, and therefore is the proper choice for investment.

APPENDIX

Journal Entries for Eads Heater, Inc. and Glenwood Heating, Inc.:

Both companies had the same financial transactions during 20X1.

General*Journal

Date	JE#	Acct*Name	DR	CR
1/2/20X1	1	Cash	160,000.00	
		Common-Stock		160,000.00
		to#ecord#ssuance#of#stock#		
1/2/20X6	2	Cash	400,000.00	
		Note-Payable		400,000.00
		To#ecord#note#payable4terms#7%#APR,#payment#due#$20,000#principle#plus#interest#on#9/		
1/3/20X1	3	Land	70,000.00	
		Building	350,000.00	
		Cash		420,000.00
		to#ecord#purchase#of#and#and#building		
1/5/20X1	4	Equipment	80,000.00	
		Cash		80,000.00
		to#ecord#purchase#of#equipment		
12/31/20X1	5	Inventory	239,800.00	
		Accounts-Payable		239,800.00
		to#ecord#credit#purchases#during#year#20X1		
12/31/20X1	6	Accounts-Receivable	398,500.00	
		Sales		398,500.00
		to#ecord#credit#sales#of#160#units#		
12/31/20X1	7	Cash	299,100.00	
		Accounts-Receivable		299,100.00
		to#ecord#eceipt#of#cash#from#sales#n#transaction#6		
12/31/20X1	8	Accounts-Payable	213,360.00	
		Cash		213,360.00
		to#ecord#payment#on#purchases#n#transaction#5		
9/30/20X1	9	Notes-Payable	20,000.00	
		Interest-Expense	21,000.00	
		Cash		41,000.00
		to#ecord#payment#of#nterest#and#principle#for#note#n#transaction#2		
12/31/20X1	10	Other-Operating-Expenses	34,200.00	
		Cash		34,200.00
		to#ecord#payment#of#advertising,#supplies,#nsurance,#and#wages#for#year#20X1		
12/1/20X1	11	Dividends	23,200.00	
		Cash		23,200.00
		to#ecord#payment#of#dividends#to#stockholders#		
12/31/20X1	12	Interest-Expense	6,650.00	
		Interest-Payable		6,650.00
		to#ecord#nterest#expense#for#ast#three#month#n#year#20X1		

Glenwood Heating & Eads Heater Chart of Accounts-First Twelve Transactions:

Glenwood Heating, Inc & Eads Heater, Inc: Chart of Accounts											
	Assets					=	Liabilities		+	Stockholders' Equity	
Part A	Cash	Accounts Receivable	Inventory	Land	Building	Equipment	Accounts Payable	Notes Payable	Interest Payable	Common Stock	Retained Earnings
JE 1	160,000.00									160,000.00	
JE 2	400,000.00							400,000.00			
JE 3	- 420,000.00			70,000.00	350,000.00						
JE 4	- 80,000.00					80,000.00					
JE 5			239,800.00				239,800.00				
JE 6		398,500.00									398,500.00
JE 7	299,100.00	- 299,100.00									
JE 8	- 213,360.00						- 213,360.00				
JE 9	- 41,000.00							- 20,000.00			- 21,000.00
JE 10	- 34,200.00										- 34,200.00
JE 11	- 23,200.00										- 23,200.00
JE 12									- 6,650.00		- 6,650.00
Balances	**47,340.00**	**99,400.00**	**239,800.00**	**70,000.00**	**350,000.00**	**80,000.00**	**26,440.00**	**380,000.00**	**- 6,650.00**	**160,000.00**	**313,450.00**

Glenwood Heating & Eads Heater Unadjusted Trail Balance:

Glenwood Heating & Eads Heater: Unadjusted Trial Balance			
Asset Accounts		**DR**	**CR**
	Cash	47,340.00	
	Accounts receivables	99,400.00	
	Allowance for bad debts		-
	Inventory	239,800.00	
	Land	70,000.00	
	Building	350,000.00	
	Accumulated depreciation-building		-
	Equipment	80,000.00	
	Accumulated depreciation-equipment		-
	Leased equipment	-	
	Accumulated depreciation-leased equipment		-
Liability Accounts			
	Accounts payable		26,440.00
	Interest payable		6,650.00
	Note payable		380,000.00
	Lease payable		-
Equity Accounts			
	Common stock		160,000.00
	Retained earnings		-
	Dividends	23,200.00	
	Sales		398,500.00
	Costs of goods sold	-	
	Bad debt expense	-	
	Depreciation expense	-	
	Interest expense	27,650.00	
	Other operating expenses	34,200.00	
	Rent expense	-	
	Provision for income taxes	-	
Total		**971,590.00**	**971,590.00**

Glenwood's Additional Financials:

Adjusted Chart of Accounts:

Glenwood Heating, Inc: Adjusted Chart of Accounts														
	Assets								=	Liabilities			+	Stockholders' Equity
	Cash	Accounts Receivable	Allowance for Bad Debts	Inventory	Land	Building	Accumulated Depreciation-Building	Equipment	Accumulated Depreciation-Equipment	Accounts Payable	Interest Payable	Notes Payable	Common Stock	Retained Earnings
Balances: Part A	47,340.00	99,400.00	-	239,800.00	70,000.00	350,000.00	-	80,000.00	-	26,440.00	- 6,650.00	380,000.00	160,000.00	313,450.00
AJE 1: Bad Debts			994.00											- 994.00
AJE 2: COGS				- 177,000.00										- 177,000.00
AJE 3: Depreciation														- 19,000.00
Building							10,000.00							
Equipment									9,000.00					
AJE 4: Equipment														
Rental Payment	- 16,000.00													- 16,000.00
AJE 5: Income Tax	- 30,914.00													- 30,914.00
Balances	426.00	99,400.00	994.00	62,800.00	70,000.00	350,000.00	10,000.00	80,000.00	9,000.00	26,440.00	- 6,650.00	380,000.00	# 160,000.00	69,542.00

Adjusting Journal Entries:

General Journal-Adjustments

Date	JE#	Acct Name	DR	CR
12/31/20X1	AJE1	Bad Debt Expense	994.00	
		Allowance for Bad Dept		994.00
		to record estimate of uncollectible accounts receivable		
12/31/20X1	AJE2	Cost of Goods Sold	177,000.00	
		Inventory		177,000.00
		to record cost of goods sold for year 20X1		
12/31/20X1	AJE3	Depreciation Expense	19,000.00	
		Accumulated Depreciation-Building		10,000.00
		Accumulated Depreciation-Equipment		9,000.00
		to record annual depreciation		
12/31/20X1	AJE4	Rent Expense	16,000.00	
		Cash		16,000.00
		to record rental of operating equipment		
12/31/20X1	AJE5	Provisions for Income Taxes	30,914.00	
		Cash		30,914.00
		to record provisions for income taxes		

Schedules:

Below one can find my calculations for values found both in Glenwood's general journal entries and adjustments.

Schedule of Purchases-JE5			
Month	Units	Cost per unit	TotalCost
Jan	40	1,000.00	40,000.00
Mar	60	1,100.00	66,000.00
Jun	20	1,150.00	23,000.00
Sept	62	1,200.00	74,400.00
Oct	28	1,300.00	36,400.00
			239,800.00

Schedule of COGS-AJE2		
Units	Cost/Unit	Total
40	1000	40,000.00
60	1100	66,000.00
20	1150	23,000.00
40	1200	48,000.00
	4450	177,000.00

Schedule of Annual Depreciation-AJE3	
Building	10000
Equipment	9000
Total	19000

Schedule of NI	
Revenue	398,500.00
Expenses	274,844.00
NI	123,656.00
Tax Provisions	30,914.00

Adjusted Trail Balance:

Glenwood Heating-Adjusted Trail Balance			
Asset Accounts		**DR**	**CR**
	Cash	426.00	
	Accounts receivables	99,400.00	
	Allowance for bad debts		994.00
	Inventory	62,800.00	
	Land	70,000.00	
	Building	350,000.00	
	Accumulated depreciation-building		10,000.00
	Equipment	80,000.00	
	Accumulated depreciation-equipment		9,000.00
	Leased equipment	-	
	Accumulated depreciation-leased equipment		-
Liability Accounts			
	Accounts payable		26,440.00
	Interest payable		6,650.00
	Note payable		380,000.00
	Lease payable		-
Equity Accounts			
	Common stock		160,000.00
	Retained earnings		-
	Dividends	23,200.00	
	Sales		398,500.00
	Costs of goods sold	177,000.00	
	Bad debt expense	994.00	
	Depreciation expense	19,000.00	
	Interest expense	27,650.00	
	Other operating expenses	34,200.00	
	Rent expense	16,000.00	
	Provision for income taxes	30,914.00	
Total		**991,584.00**	**991,584.00**

Ead's Additional Financials:

<u>Adjusted Chart of Accounts:</u>

Eads Heater, Inc: Adjusted Chart of Accounts																	
	Assets											= Liabilities				+ Stockholders' Equity	
	Cash	Accounts Receivable	Allowance for Bad Debts	Inventory	Land	Building	Accumulated Depreciation-Building	Equipment	Accumulated Depreciation-Equipment	Leased Equipment	Accumulated Depreciation-Lease	Accounts Payable	Interest Payable	Notes Payable	Lease Payable	Common Stock	Retained Earnings
Balances: Part A	47,340.00	99,400.00	-	239,800.00	70,000.00	350,000.00	-	80,000.00	-	-	-	26,440.00	-6,650.00	380,000.00	-	160,000.00	313,450.00
AJE 1: Bad Debts			4,970.00														-4,970.00
AJE 2: COGS				-188,800.00													-188,800.00
AJE 3: Depreciation																	-30,000.00
Building							10,000.00										
Equipment									20,000.00								
AJE 4: Equipment										92,000.00							
Lease															92,000.00		
Lease Payment	-16,000.00														-8,640.00		-7,360.00
Depreciation											11,500.00						-11,500.00
AJE 5: Income Tax	-23,505.00																-23,505.00
Balances	7,835.00	99,400.00	4,970.00	51,000.00	70,000.00	350,000.00	10,000.00	80,000.00	20,000.00	92,000.00	11,500.00	26,440.00	-6,650.00	380,000.00	83,360.00	160,000.00	47,315.00

Adjusting Journal Entries:

General*Journal5Adjustments

Date	JE#	Acct*Name	DR	CR
12/31/20X1	AJE1	Bad-Debt-Expense	4,970.00	
		Allowance-for-Bad-Debt		4,970.00
		to#ecord#estimate#bf#uncollectible#accounts#eceivable#		
12/31/20X1	AJE2	Cost-of-Goods-Sold	188,800.00	
		Inventory		188,800.00
		to#ecord#cost#bf#goods#sold#for#year#20X1		
12/31/20X1	AJE3	Depreciation-Expense	30,000.00	
		Accumulated-DepreciationKBuilding		10,000.00
		Accumulated-DepreciationKEquipment		20,000.00
		to#ecord#annual#depreciation#		
12/31/20X1	AJE4	Leased-Equipment	92,000.00	
		Lease-Payable		92,000.00
		Interest-Expense	7,360.00	
		Lease-Payable	8,640.00	
		Cash		16,000.00
		Depreciation-Expense	11,500.00	
		Accumulated-DepreciationKLeased-Equipment		11,500.00
		to#ecord#capital#ease#bf#equipment		
12/31/20X1	AJE5	Provisions-for-Income-Taxes	23,505.00	
		Cash		23,505.00
		to#ecord#payment#bf#ncome#taxes		

Schedules:

Below one can find my calculations for values found both in Glenwood's general journal entries and adjustments.

Schedule of Purchases-JE5			
Month	Units	Cost per unit	TotalCost
Jan	40	1,000	40,000.00
Mar	60	1,100	66,000.00
Jun	20	1,150	23,000.00
Sept	62	1,200	74,400.00
Oct	28	1,300	36,400.00
			239,800.00

Schedule of COGS-AJE2		
Units	Cost/Unit	Total
28	1300	36400
62	1200	74400
20	1150	23000
50	1100	55000
	4750	188800

Schedule of Annual Depreciation-AJE3	
Building	10000
Equipment	20000
Total	30000

Schedule of NI	
Revenue	398,500.00
Expenses	304,480.00
NI before	94,020.00
Tax Provisions	23,505.00

<u>Adjusted Trial Balance:</u>

Eads Heaters-Adjusted Trail Balance			
Asset Accounts		**DR**	**CR**
	Cash	7,835.00	
	Accounts receivables	99,400.00	
	Allowance for bad debts		4,970.00
	Inventory	51,000.00	
	Land	70,000.00	
	Building	350,000.00	
	Accumulated depreciation-building		10,000.00
	Equipment	80,000.00	
	Accumulated depreciation-equipment		20,000.00
	Leased equipment	92,000.00	
	Accumulated depreciation-leased equipment		11,500.00
Liability Accounts			
	Accounts payable		26,440.00
	Interest payable		6,650.00
	Note payable		380,000.00
	Lease payable		83,360.00
Equity Accounts			
	Common stock		160,000.00
	Retained earnings		-
	Dividends	23,200.00	
	Sales		398,500.00
	Costs of goods sold	188,800.00	
	Bad debt expense	4,970.00	
	Depreciation expense	41,500.00	
	Interest expense	35,010.00	
	Other operating expenses	34,200.00	
	Rent expense	-	
	Provision for income taxes	23,505.00	
Total		**1,101,420.00**	**1,101,420.00**

Case 2: FASB Codification analysis

TOTZ AND DOODLES

Executive Summary

In order to help a company properly determine their appropriate income statement presentation, I researched and analyzed income statement information. Totz, an SEC registrant, manufactures and sells high quality children's clothing. Recently, Totz stores also began to include Doodlez, an in-store art studio, which offers painting, pottery, and drawing classes and began serving customers during the third quarter of fiscal year 2015. The following case delves into Totz' financial information and can be useful in determining how to present this year's income statement items. Reasoning and justification for each presentation decision is found on the FASB's Accounting Standards Codification website. A number of my authoritative support came from the SEC in addition to the ones that were found as standards within the codification.

Net Sales

First, I analyzed Totz and Doodlez' net sales. Each company listed their appropriate dollar amounts of the past two fiscal years and explained why both had large increases in their net sales between years 2015 and 2016. Between the two fiscal years, Totz chose to increase the amount of natural fibers in their clothing, raising the price, increasing both companies' net sales. Totz and Doodlez need to list their personal sales amounts as a subset in order to separate the two entities on the income statement. According to the SEC's rules on income statements, number 225-10-S99-2:

210.5–03.1, each class which is not more than 10 percent of the sum of the items may be combined with another class. If these items are combined, related costs and expenses as described under § 210.5–03.2 shall be combined in the same manner. 1. Net sales and gross revenues. State separately: Net sales of tangible products (gross sales less discounts, returns and allowances), operating revenues of public utilities or others; income from rentals; revenues from services; and other revenues.

Totz' total net sales for 2016 were $86.5 million. Doodlez consisted of $11.2 million and was 14.87% of the company's total sales. Concluded from the rule stated, a company, which has sub captions of less than ten percent of the sum of the items, can be combined. Because Doodlez accounted for more than ten percent of sales this past year, Totz must separate the two entities on their income statement. Separately, readers see the individual sales contributed from both companies, which can then be calculated to show the combined net sales for Totz and Doodlez.

Gross Profit

Gross profit, which represents net sales less cost of sales, was the second income statement item I was asked to review. Totz recently saw an 8.6% increase in their gross profit and an increase of 20.6% in cost of sales. This is a result of an increase in the cost of services provided by Doodlez. The best place for Totz and Doodlez to list their cost of sales is under other operating income. The cost of sales incurred to acquire and produce inventory for sale should be placed under other operating income on the company's income statement. Each company will be listed separately, as specified in number one, in

order to properly disclose each company's operating amount. The following is from the SEC's 225-10-S99-2:

> Costs and expenses applicable to sales and revenues. State separately the amount of cost of tangible goods sold, operating expenses of public utilities or others, expenses applicable to rental income, cost of services, and expenses applicable to other revenues. Merchandising organizations, both wholesale and retail, may include occupancy and buying costs under caption 2(a). Amounts of costs and expenses incurred from transactions with related parties shall be disclosed as required under § 210.4–08(k).

In addition, I found another rule that illustrates why each company needs to place their cost of sales under other operating income. The following rule is from the SEC's 225-10-S99-3 and helps address Totz' issue with expenses:

> Therefore, in specific situations, the staff has required the subsidiary to revise its financial statements to include certain expenses incurred by the parent on its behalf. Examples of such expenses may include, but are not necessarily limited to, the following (income taxes and interest are discussed separately below): 1. Officer and employee salaries 2. Rent or depreciation 3. Advertising

Because Doodles is new, it is likely that Totz has had expenses be incurred through the formation of Doodlez, which was never accounted for under their expenses. Although Doodlez did not directly incur those costs, they will need to revise their financial statements in order to show where their parent company incurred those costs on their behalf. A perfect example of this might be an advertising expense as listed in the above rule. Such costs would have been incurred through the formation of the new business in

order to ensure its success and make certain customers knew of the company's growth, though this may not have been specifically mentioned. The final rule that I used was found in the SEC's 225-10-S99-8:

> If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: 'Cost of goods sold (exclusive of items shown separately below)' or 'Cost of goods sold (exclusive of depreciation shown separately below).' To avoid placing undue emphasis on 'cash flow,' depreciation, depletion and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation.

To make sure the company is not overstating or placing "undue emphasis on 'cash flow,'" Totz needs to make sure to exclude their depreciation expenses when they calculate their cost of goods sold.

<u>Gain on Sale of Corporate Headquarter</u>

I then analyzed the relocation of Totz' corporate headquarters to Mountain View, CA. During the relocation process, Totz sold their abandoned building and realized a gain of $1.7 million. While researching through the FASB Codification, I found the following rule; 205-20-45-1:

> The results of operations of a component of an entity that either has been disposed of or is classified as held for sale under the requirements of paragraph 360-10-45-9, shall be reported in discontinued operations in accordance with paragraph 205-20-45-3 if both of the following conditions are met: a. The operations and cash

> flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction. b. The entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

My best advice for Totz is to include the gain on the sale of their abandoned building under discontinued operations on their income statement. This allows the audience to see this large material event and understand where the gain is originating. In addition to the rule, I also found the following, which directly states and shows how to graphically display discontinued operations. This valuable information and picture can be located on 205-20-45-3A:

> The results of all discontinued operations, less applicable income taxes (benefit), shall be reported as a separate component of income. For example, the results of all discontinued operations may be reported in the statement where net income of a business entity is reported as follows.

Income from continuing operations before income taxes	$XXXX	
Income taxes	XXX	
Income from continuing operations [a]		$XXXX
Discontinued operations (Note X)		
Loss from operations of discontinued Component X (including loss on disposal of $XXX)		XXXX
Income tax benefit		XXXX
Loss on discontinued operations		XXXX
Net income		$XXXX

[a] This caption should be modified appropriately when an entity reports an extraordinary item. If applicable, the presentation of per-share data will need similar modification.

This image helps to capture what both rules are stating and will prove to be very useful when Totz creates this year's income statement. As seen above, the line that reads "loss on discontinued operations" would need to be changed to gain, and added instead of subtracted to reach the company's final net income for the fiscal year.

Class Action Settlement

Totz settled a class action lawsuit related to the legal case against the natural fiber supplier who had falsely been selling Totz "natural" materials this past fiscal year which won Totz $2.7 million in proceeds. This settlement resulted in Totz receiving $2.7 million in proceeds. After researching, I opted to disclose this class action settlement in the company's notes rather than directly on the income statement because of its unusual and infrequent nature. Rule 225-20-45-16 will support my logic:

> A material event or transaction that is unusual in nature or occurs infrequently but not both, and therefore does not meet both criteria for classification as an extraordinary item, shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be disclosed on the face of the income statement or, alternatively, in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes or in any other manner that may imply that they are extraordinary items. Similarly, the EPS effects of those items shall not be presented on the face of the income statement.

Because Totz reaped the benefits from an infrequent class action lawsuit, it would be best for the company to disclose this material event in their notes when they create their income statement at the end of the coming fiscal year. While choosing to include this event needs to be recognized, I have decided for the coming year, such information should be placed within the notes rather than directly on the income statement.

Case 3: Financial Statements Analysis of Rocky Mountain Chocolate Factory

Journal Entries:

General Journal			
JE#	**Account Name**	**DR**	**CR**
1	Inventory	7,500,000	
	Accounts Payable		7,500,000
2	Inventory	6,000,000	
	Accrued Salaries and Wages		6,000,000
3	Cash	17,000,000	
	Accounts Receivable	5,000,000	
	Sales		22,000,000
	Cost of Sales	14,000,000	
	Inventory		14,000,000
4	Accounts Payable	8,200,000	
	Cash		8,200,000
5	Cash	4,100,000	
	Accounts Receivable		4,100,000
6	Sales and Marketing Expense	1,505,431	
	General and Administrative Expense	2,044,569	
	Retail Operating Expense	1,750,000	
	Cash		2,000,000
	Other Accrued Expense		3,300,000
7	Accrued Salaries and Wages	6,423,789	
	Cash		6,423,789
8	Cash	125,000	
	Deferred Income		125,000
9	Property and Equipment, Net	498,832	
	Cash		498,832
10	Retained Earnings	2,407,167	
	Cash		2,403,458
	Dividends Payable		3,709

Journal Entries Continued:

	Adjusting Entries		
AJE#12	Cost Of Sales	216,836	
	Inventory		216,836
AJE#13	Depreciation and Amortization	698,580	
	Property and Equipment, Net		698,580
AJE#14	General and Administrative	639,200	
	Retail Operating	6,956	
	Accrued Salaries and Wages		646,156
AJE#15	No Entry		
	Closing Entries		
16	Sales	22,944,017	
	Franchise and Royalty fees	5,492,531	
	Interest Income	27,210	
	Income Summary		28,463,758
	Income Summary	24,883,681	
	Cost of Sales		14,910,622
	Franchise Costs		1,499,477
	Sales and Marketing		1,505,431
	General and Administrative		2,422,147
	Retail Operating		1,756,956
	Depreciation and amortization		698,580
	Income Tax Expense		2,090,468
	Income Summary	3,580,077	
	Retained Earnings		3,580,077

Rocky Mountain Chocolate Factory trail balance:

Rocky Mountain Chocolate Factory, Inc.		
Unadjusted Trial Balance		
Account	**DR**	**CR**
Cash and Cash Equivalents	3,743,092	
Accounts Receivable	4,427,526	
Notes Receivable, net	91,059	
Inventories	3,498,283	
Deferred Income Taxes	461,249	
Other Current Assets	220,163	
Property and Equipment, net	5,885,289	
Notes Receivable, less current portion	263,650	
Goodwill, net	1,046,944	
Intangible Assets, net	110,025	
Other Long-Term Assets	88,050	
Accounts Payable		877,832
Accrued Salaries and Wages		-
Other Accrued Expenses		946,528
Dividend Payable		602,694
Deferred Income		220,938
Deferred Income Taxes		894,429
Common Stock		180,808
Additional Paid-in Capital		7,626,602
Retained Earnings		3,343,850
Sales		22,944,017
Franchise and Royalty Fees		5,492,531
Cost of Sales	14,693,786	
Franchise Costs	1,499,477	
Sales and Marketing	1,505,431	
General and Administrative	1,782,947	
Retail Operating	1,750,000	
Depreciation and Amortization	-	
Interest Income		27,210
Income Tax Expense	2,090,468	
Total	**$ 43,157,439**	**$ 43,157,439**

Rocky Mountain Chocolate Factory, Inc.		
Adjusted Trial Balance		
Account	**DR**	**CR**
Cash and Cash Equivalents	3,743,092	
Accounts Receivable	4,427,526	
Notes Receivable, net	91,059	
Inventories	3,281,447	
Deferred Income Taxes	461,249	
Other Current Assets	220,163	
Property and Equipment, net	5,186,709	
Notes Receivable, less current portion	263,650	
Goodwill, net	1,046,944	
Intangible Assets, net	110,025	
Other Long-Term Assets	88,050	
Accounts Payable		877,832
Accrued Salaries and Wages		646,156
Other Accrued Expenses		946,528
Dividend Payable		602,694
Deferred Income		220,938
Deferred Income Taxes		894,429
Common Stock		180,808
Additional Paid-in Capital		7,626,602
Retained Earnings		3,343,850
Sales		22,944,017
Franchise and Royalty Fees		5,492,531
Cost of Sales	14,910,622	
Franchise Costs	1,499,477	
Sales and Marketing	1,505,431	
General and Administrative	2,422,147	
Retail Operating	1,756,956	
Depreciation and Amortization	698,580	
Interest Income		27,210
Income Tax Expense	2,090,468	
Total	**$ 43,803,595**	**$ 43,803,595**

Rocky Mountain Chocolate Factory, Inc.		
Post Closing Trial Balance		
Account	**DR**	**CR**
Cash and Cash Equivalents	3,743,092	
Accounts Receivable	4,427,526	
Notes Receivable, net	91,059	
Inventories	3,281,447	
Deferred Income Taxes	461,249	
Other Current Assets	220,163	
Property and Equipment, net	5,186,709	
Notes Receivable, less current portion	263,650	
Goodwill, net	1,046,944	
Intangible Assets, net	110,025	
Other Long-Term Assets	88,050	
Accounts Payable		877,832
Accrued Salaries and Wages		646,156
Other Accrued Expenses		946,528
Dividend Payable		602,694
Deferred Income		220,938
Deferred Income Taxes		894,429
Common Stock		180,808
Additional Paid-in Capital		7,626,602
Retained Earnings		6,923,927
Sales		-
Franchise and Royalty Fees		-
Cost of Sales	-	
Franchise Costs	-	
Sales and Marketing	-	
General and Administrative	-	
Retail Operating	-	
Depreciation and Amortization	-	
Interest Income		-
Income Tax Expense	-	
Total	**$ 18,919,914**	**$ 18,919,914**

Rocky Mountain Chocolate Factory Financial Statements:

Rocky Mountain Chocolate Factory, Inc. Income Statement For the year end February 28, 2010	
Revenues	
Sales	$ 22,944,017
Franchise and Royalty Fees	5,492,531
Total Revenue	28,436,548
Cost and Expenses	
Cost of Sales	14,910,622
Franchise Costs	1,499,477
Sales & Marketing	1,505,431
General & Administrative	2,422,147
Retail Operating	1,756,956
Depreciation and Amortization	698,580
Total Costs and Expenses	22,793,213
Operating Income	5,643,335
Other Revenues and Expenses	
Interest Income	27,210
Income before taxes	5,670,545
Income Tax Expense	2,090,468
Net Income	**$ 3,580,077**

Rocky Mountain Chocolate Factory, Inc. Statement of Retained Earnings For Year End February 28, 2010	
Retained Earnings, March 1, 2009	5,751,017
Add: Net Income	3,580,077
Less: Dividends	2,407,167
Retained Earnings, February 28, 2010	**6,923,927**

Rocky Mountain Chocolate Factory, Inc.
Balance Sheet
February 28,2010

Assets		Liabilities and Stockholders' Equity	
Current Assets		**Current Liabilities**	
Cash and Cash Equivalents	$ 3,743,092	Accounts Payable	$ 877,832
Accounts Receivable	4,427,526	Accrued Salaries and Wages	646,156
Notes Receivable, Current	91,059	Other Accrued Expenses	946,528
Inventories	3,281,447	Dividend Payable	602,694
Deferred Income Taxes	461,249	Deferred Income	220,938
Other	220,163	Total Current Liabilities	3,294,148
Total Current Assets	12,224,536		
		Deferred Income Taxes	894,429
Property and Equipment, net	5,186,709		
		Stockholders' Equity	
Other Assets		Common Stock	180,808
Notes Receivable, less current portion	263,650	Additional Paid-In Capital	7,626,602
Goodwill, net	1,046,944	Retained Earnings	6,923,927
Intangible Assets, net	110,025	Total Stockholders' Equity	14,731,337
Other Long Term Assets	88,050	**Total Liabilities and Stockholders' Equity**	**$18,919,914**
Total Other Assets	1,508,669		
Total Assets	**$18,919,914**		

CASE 4: Internal Control Suggestions
KAYLA STEVENS

Dear Kayla,

Thank you for hiring the Owen Consulting Group, LLP. We are excited to help you with your internal controls. After evaluating your business, my team and I have identified areas where your business is subject to fraud. Please refer to the attachment below for our recommendations.

Sincerely,

Forbes Owen

Forbes Owen

Owen Consulting Group, LLP.

Potential Fraud	Internal Control
- Potential fraud in management - Lack of responsibility - Lack of accountability	**Separation of Duties:** There needs to be some implementation of tasks that change hands on a regular basis to ensure consistent work with no signs of fraud. In general, clerks should have more responsibilities to even out the work load.
- Lack of monitoring the store - Out of date software	**Technology Update**: Kayla needs to update her accounting software due to updates that would help stop any fraud. Also, Kayla should install cameras to help observe operations at all times. (Their credit card machines are behind the register leaving the registers vulnerable).
- Lack of reporting - Lack of distribution of information - Lack of accountability - Timeliness (Reporting) - Verifiability Fraud	**Frequent Reporting**: There needs to be weekly or bi-weekly reports that can summarize cash flows or other operations inside of the store to be used to hold the associated clerk, via ID number, accountable.
- Lack of reporting - False transactions - Verifiability of sales - Falsified inventory records	**Inventory Checks**: This shop needs to personally use the frequent reports and physically check random parts of inventory to ensure there are no false sales. It is vital that proper personnel check and balances are used in reporting. The store should increase the responsibility of the clerks by having them accountant for specific parts of the store/inventory.
- Employee pocketing cash - Falsified records - Verifiability - Falsifying sales	**Register Checks**: Each day, Kayla should ensure that the registers start at a certain monetary value. At the end of business each day, that register should be counted back down to the normal balance, and the clerk should be held accountable for every transaction that passes through their hands.

- Complacent staff - Lack of teamwork	**Team Management**: It may be a good idea to look into hiring more people, or questioning some of the workers (Becca would be a good start due to her small investment in the company of working one day a week.) to ensure consistent quality without workers who are complacent and comfortable. At the very least, there should be team meetings and extra training.
- Accountability Fraud - Verifiability	**Checks and Balances**: To go along with separation of duties, there should always be at least two people involved with every process. Lucy and Kayla need to have someone else to hold them accountable. This would in turn take a lot of their individual freedom away and make any type of internal fraud more difficult to perform.

Case 5:
INVENTORY IMPARIMENT

1.
    - Raw Materials: Direct and indirect materials
    - Work in Process: Direct labor, indirect labor, and factory overhead
    - Finished Goods: Direct labor, direct materials, and overhead
2. The inventories are net of allowance for obsolete and unmarketable inventory.
3.
    - Current assets-contra to inventory to give net inventory amount
    - Gross amounts of inventory:
        a. 2011: 233,070 + 10,800 = 243,870
        b. 2012: 211,734 + 12,520 = 224,254
    - RM least obsolete and FG would account for the most obsolete and unmarketable inventory. When we make errors with our RM, chances are we will still be able to re-use our scrap parts. However, once a good has been finished it can become obsolete and therefore unmarketable and can account for a large portion of a company's obsolete and unmarketable inventory.
4. Create Expense Account:

DR: Obsolete Inventory Expense	13,348	
CR: Allowance for Obsolete and Unmarketable Inventory		13,348

Write Off Inventory:

DR: Allowance for Obsolete and Unmarketable Inventory 11,628

CR: Inventory 11,628

5.

Raw Materials Inventory

Debit	Credit
46,976.00	
438,561.00	
	442,068.00
43,469.00	

Work in Process Inventory

Debit	Credit
1,286.00	
126,000.00	
442,068.00	
	568,735.00
619.00	

Finished Goods Inventory

Debit	Credit
184,808.00	
	13,348.00
568,735.00	572,549.00
167,646.00	

Cost of Sales

Debit	Credit
-	
13,348.00	
572,549.00	
585,897.00	

Accounts Payable

Debit	Credit
	39,012.00
	438,561.00
432,197.00	
	45,376.00

a. Cost of finished goods sold = $572,549

b. Cost of finished goods transferred from work-in-process = $568,735

c. Cost of raw materials transferred to work-in-process = $442,068

d. Cost of raw materials purchased in 2012 = $438,561

e. Amount of cash disbursed for raw material purchases during 2012 = $20,216

6. Below you can see the company's current and prior year inventory turnover ratios.

	Cost of Sales	Average Inventory	Inventory Turnover Ratio
2011	575,226.00	250,830.50	2.29
2012	585,897.00	222,402.00	2.63

7. Below I calculated the company's inventory holding period for its current and prior years. In 2011 the company had an inventory holding period of approximately 160 days and in 2012 it was approximately 139 days. After

comparing these two numbers, one can tell that this company has become more efficient over the last year.

	365 /	Inventory Turnover	Inventory Holding Period
2011	365	2.29	159.39
2012	365	2.63	138.55

8. As a potential investor, I would love to see the firm calculate debt-to-equity, return on assets, days sales outstanding, and times interest earned. All of these will aid investors in their analysis of the company and enable them to make sound business decisions. The above information will give investors insight to the firm's solvency, liquidity, and financial flexibility.

	Obsolete Inv. /	FG Inv. + Obsolete	Percent of Inv., Obsolete
2012	13,348.00	167,464 + 13,348	7.38%

CASE 6: Capitalized Costs and Earning

WORLDCOM INC.

A. FASB Statement of Concepts No. 6:

   a. The FASB Statement of Concepts No. 6 defines an asset as a "probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events". In other words, an asset is an expected future benefit or revenue that a company hopes to reap in the future. Concept No. 6 defines an expenses as an outflow after the company has received services, carried out major operations, or produced goods.

   b. In order for a cost to capitalized it needs to provide a future benefit or revenue. We must consider whether these expenses will match future revenues. There is definitely some judgement that goes into whether or not a cost should be capitalized or expensed right away. If an asset's useful life is increased, the quantity of service is increased, and/or the quality is enhanced an asset should be capitalized.

B. After costs have been capitalized, we depreciate the cost until it's reached its salvage value. Assets on the balance sheet decrease and net income will decrease because depreciation expense is increasing throughout the years.

C. WorldCom reported line costs of $14,739,000,000 at the end of 2001. These line costs were charges to the local telephone networks. The following is the journal entry that WorldCom made in reporting these line costs.

DR: Line Cost Expense	14,739,000,000	
CR: Cash or Payable		14,739,000,000

D. After referencing the *Wall Street Journal's* article, we can see that WorldCom was improperly capitalizing their line costs. WorldCom capitalized charges paid to their local telephone company when they should not have. Scott Sullivan, WorldCom's CFO, slyly placed these expenses under capital expenditures when they were simple operating expenses. Through a simple journal entry, Sullivan was able to turn a significant loss into a profit.

E. The following is the journal entry to record the improperly capitalized line costs. These costs appeared under property, plant, and equipment in the communications or transmissions equipment account on the balance sheet. These same costs would appear on the statement of cash flows in the operating activities section under capital expenditures.

DR: PPE Account	3,055,000,000	
CR: Line Cost Expense		3,055,000,000

F.

f.	Capitalized Amount X	Useful Life / Quarter		
1st Quarter	711,000,000	22	4/4	35,045,455
2nd Quarter	610,000,000	22	3/4	20,795,454
3rd Quarter	743,000,000	22	2/4	16,886,364
4th Quarter	931,000,000	22	1/4	10,579,545
				83,306,818
Calculated useful life = 22 years				

DR: Depreciation Expense 83,306,818

CR: Accumulated Depreciation 83,306,818

WorldCom Inc. Corrected Income Statement g. FYE 12/31/01		
Income before taxes		2,393,000,000
Depreciation from part F		83,306,818
Line costs improperly capitalized	-	3,055,000,000
Loss before taxes, restated	-	578,693,182
Income tax benefit		202,542,614
Minority interest		35,000,000
Net Loss	-	341,150,568

G.

Case 7: Benefits and Retraining

TARGA COMPANY

1. Targa Company has just informed their employees that they will be restructuring their business line in the coming months. The company sent out formal notices on December 27, 20X1 all employees making their intentions known and informing all workers of their severance packages upon closing of their facility. The workforce reduction is expected to be completed by January 31, 20X2. The company plans to cut back approximately ten percent of their total workforce. The current facility will be restructured to help house expansion for another division. The following FASB rule can be used to support Targa's having met their one-time employee termination criteria 420-10-25-4:

> An arrangement for one-time employee termination benefits exists at the date the plan of termination meets all of the following criteria and has been communicated to employees (referred to as the communication date): a. Management, having the authority to approve the action, commits to a plan of termination. b. The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date. c. The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of

benefits they will receive if they are involuntarily terminated. d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Targa Company's promise to provide these one-time employee benefits creates an obligation, or liability, for the company that must be carried out. The following supports this; 420-10-25-5:

> An entity's communication of a promise to provide one-time employee termination benefits is a promise that creates an obligation at the communication date to provide the termination benefits if employees are terminated.

Targa has agreed to pay $2.5 million in termination benefits to their laid-off employees, two weeks' severance of $500,000, as well as compensate their facility manager with a lump-sum of $50,000 upon closure. All of these employee benefit expenses should be accounted for as a liability on Targa's 20X1 financial statements. The FASB's rule, 712-10-25-1 can be used to support this classification:

> Nonretirement postemployment benefits offered as special termination benefits to employees shall be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that offers, for a short period of time, special termination benefits to employees, shall not recognize a loss at the date the offer is made based on the estimated acceptance rate.

2. In addition to the one-time termination costs Targa will incur, relocation costs of $500,000 and training costs of $1.5 million will also be added to their total

expense. Targa should classify these retraining and relocation costs as the reengineering costs as they're incurred per the SEC's rule; 720-45-55-1:

Steps	Third Party		Internal	
	Expense	Capitalize	Expense	Capitalize
Business process reengineering and information technology transformation:				
Preparation of request for proposal	a		a	
Current state assessment	a		a	
Process reengineering	a		a	
Restructuring work force	a		a	
Preliminary software project stage activities:				
Conceptual formulation of alternatives	b		b	
Evaluation of alternatives	b		b	
Determination of existence of needed technology	b		b	
Final selection of alternatives	b		b	
Application development stage activities:				
Design of chosen path, including software configuration and software interface		c		c
Coding		c		c
Installation to hardware		c		c
Testing, including parallel processing phase		c		c
Data conversion costs:				
a. Costs to develop or obtain software that allows for access of old data by new system		c		c
b. All other data conversion processes	b		b	
Training	b		b	
Post-implementation/operation stage activities:				
Training	b		b	
Application maintenance	b		b	
Ongoing support	b		b	
Acquisition of fixed assets:				
Purchase of new computer equipment, office furniture, or work stations		d	N/A	N/A
Reconfiguration of work area—architect fees and hard construction costs		d		d

In addition to the above image, the following rule specifies even more thoroughly what can be expensed during a reengineering of a business. Found under the SEC's 720-45-25-2:

> The following third-party or internally generated costs typically associated with business process reengineering shall be expensed as incurred: a. Preparation of request for proposal—the process of preparing a proposal. b. Current state assessment—the process of documenting the entity's current business process, except as it relates to current software structure. This activity is sometimes called mapping, developing an as-is baseline, flow charting, and determining current business process structure. c. Process reengineering—the effort to reengineer the entity's business process to

increase efficiency and effectiveness. This activity is sometimes called analysis, determining best-in-class, profit and performance improvement development, and developing should-be processes. d. Restructuring the work force—the effort to determine what employee makeup is necessary to operate the reengineered business processes.

Targa Company's relocation costs can be expensed both internally and for their third-party partners who they've entered into irrevocable contracts with for the coming eighteen months. This can be seen in the first paragraph in the above image. Everything including their process reengineering, restricting of their work force, and preparation can be expensed as incurred. Targa's retraining costs can be expensed as incurred as well for both third-party partners and internally for Targa. This can be seen in the fourth paragraph entitled "post-implementation/operation stage activities" in the above image.

Case 8: Equity Case Study

MERECK

A. Merck's Common Shares:

i. Merck authorized 5,400,000,000 common shares.

ii. Merck issued 2,983,508,675 common shares on December 31, 2007.

iii. The reconciled number of shares to the dollar value of common stock will equal the following: 2,983,508,675 X .01 = 29,835,086.75

iv. Merck held 811,005,791 shares of treasury stock at December 31, 2007.

v. Merck has 2,172,502,884 common shares. This was calculated by subtracting treasury stock from their total issued common shares:

   2,983,508,675 - 811,005,791 = 2,172,502,884

vi. Merck's Market Capitalization = 2,172,502,884 X $57.61 = 125,157,891,147

C. Companies distribute dividends to their shareholders in order to share their successes from the year with their investors. Shareholders own a percentage of the company so they will be given a percentage of the company's profit in hopes that the company will continue to receive investments and make their shareholders happy. Distributing dividends also sends a positive signal to potential investors that the company is profitable and perhaps even growing. When a company distributes dividends their stock price will go down in price.

D. Companies choose to repurchase their own shares for various reasons. One of the main reasons a company might repurchase shares would be to gain more control over their company. Holding a greater number of shares might bring them the extra shares they needed to vote on a new business decision to expand or purchase a new division for their company.

E.			
E.	DR: Retained Earnings	3,310,700,000	
	CR: Dividends Payable		3,400,000
	CR: Cash		3,307,300,000

G. Merck repurchased its own common shares on the open market:

i. Merck used the cost method to account for treasury stock.

ii: According to note 11 Merck repurchased 26.5 million shares on the open market during 2007.

iii. Merck paid in total $1,429.7 billion and per share $53.95 per share when they repurchased shares on the open market. This repurchase was a financing cash flow.

iv. Treasury stock is a contra-equity account therefore it cannot be listed as an asset.

I. Merck's stock price has seen a significant increase over the past year. However, the company's net income has fallen over the past year as well as the amount of dividends paid. Merck's total assets and operating cash flows saw a great increase over the past year. All of the above statistical information suggests that Merck has had a successful year once more and will continue to be successful in the coming years.

In millions	2007	2006
Dividends Paid	3,307.30	3,322.60
Shares Outstanding	2,172.50	2,167.80
Net Income	3,275.40	4,433.80
Total Assets	48,350.70	44,569.80
Operating Cash Flows	6,999.20	6,765.20
Year-end Stock Price	57.61	41.94
Dividends per Share	1.52	1.53
Dividend Yield	2.64%	3.65%
Dividend Payout	1.01	0.75
Dividends to Total Assets	0.068	0.075
Dividends to Operating Cash Flows	0.473	0.491

Case 9: Stock Based Compensation
XILINIX, INC.

A. Many times companies offer stock options to help incentivize their employees instead of motivating them through cash like bonuses. These plans often times are used to attract and retain high-performing individuals. Employees are initially issued an additional paid in capital of stock options that they can later exercise right to exchange for common stock in their companies.

Stock options help to motivate employees to work hard and help boost the company's stock value. This in turn both aids their company and themselves because of their stake within the company's value through their stock options. Having stock options in place might even incentivize employees to stay at the company for longer than a couple of years. Typically, employees are not immediately given common stock. Often times there is a stipulate within the option that employees must wait a certain number of years before exercising their stock option rights.

B. Many companies like Xilinx offer restricted stock along with stock options. This is offered because unlike stock options, restricted stocks never become worthless. Unlike a stock option, RSUs are actual shares of ownership in a corporation. Restricted stock is non-transferrable and has a number of regulations it must comply with from the SEC. A RSU encourages long-term employee commitment whereas a stock option can give employees incentives to boost the stock price and exercise a stock option on a short term basis.

C. Grant Date→ The first day of the offering period.

Exercise Price→ The price per share the owner of an option is entitled to buy/sell their security for.

Vesting Period→ The time Xilinx's employees must wait to exercise their stock options.

Expiration Date → The third Friday of the contract month.

Options/RSUs Granted→ Employee has the option to hold a RSU or stock option if they meet the requirements.

Options Exercised→ Employees exercise their right to turn their additional paid in capital to real shares of the company; like common stock.

Options/RSUs forfeited or cancelled→ Employees might not make it through vesting period; perhaps they are offered a better job elsewhere. They are required to return any dividends they received during the vesting period.

D. The stock purchase plan allows employees to purchase at a discount of the fair market value. The stock option plan allows individuals to only purchase at a certain price. Whereas RSU is a purchase of a certain number of shares. Xilinx employees are offered the opportunity to obtain a 24-month purchase right to purchase the company's common stock at the end of each six-month period. This participation is limited to 15% of the employee's annual earnings up to $21 thousand in a calendar year. Approximately 78% of all eligible employees participate in the company's employee stock purchase plan. This all in turn encourages employees to keep the stock price high from period to period.

E. Xilinx's note 2 discusses stock based compensation and describes it as an equity incentive plan for employees. GAAP requires that share-based payment be used to

measure the cost of all employee equity awards that are expected to be exercised and that they record the cost as an expense. Xilinx uses straight-line amortization to recognize stock-based compensation costs over the employee's service period. Xilinx's stock based compensation plan is viewed as compensatory plan under GAAP for share-based payment and is also included in the computation of stock-based compensation expense.

F. i. Total expenses reported for before tax stock-based compensation in 2013→

$77,862

ii. Xilinx includes this expense on their income statement as an operating expense. These expenses are broken up into various expenses like research and development and selling, general, and administrative expenses.

iii. Xilinx will add these expenses back into the operating statement of cash flows.

iv. The income tax effects of Xilinx's 2013 stock-based compensation expense:

-this is a deferred tax asset because you have an obligation to pay this income tax in the future. This creates a deduction in the future.

v. Journal entry for Xilinx's 2013 stock-based compensation expense:

Deferred Tax Asset	22,137	
Income Tax Payable		22,137

I. i. The article "Last Gasp for Stock Options" discusses how the popularity of stock options has declined since its peak in 1999. The CFO Journal of the Wall Street Journal says that stock options once "accounted for about 78% of the average executive's long-term incentive packages. Last year, they represented just 31% and are expected to shrink to 25% in the next 2 years". The articled discussed restricted stock as well and mentioned that rather than giving an employee the option to buy stock at a specified "strike price" on

a predetermined date like stock options, they offer employees the opportunity to receive the full value of a company's stock on a specified date or when their performance goal has been reached. Stock options tend to generate more wealth for employees, whereas restricted stock is a simpler form of compensation that is subject to less accounting and tax intricacies. Employees and companies have grown to favor restricted stock over stock options because of its simplicity and ease of exercising.

ii. When observing Xilinx's footnotes on their number of stock options and restricted stock issued one can see the decline in the number of shares issued through stock options and an increase in the number of restricted stock. This coincides with the Wall Street Journal's article and brings to life what the article said about stock options and restricted stock trends. According to the company's footnotes, on April 3,2010 they had 31,026 shares of stock options and as of March 30,2013 they only had 12,753 shares. The weighted-average exercise price per share has also declined between those dates; going from $30.51 to $28.01. Contrary to stock options, restricted stock has seen a large increase over the past few years. They have risen from 3,652 shares on April 3, 2010 to 5,996 shares on March 30, 2013. The weighted-average grant-date fair value per share has also seen a large increase; going from $21.70 to $30.83 between the same respective dates.

Case 10: Revenue Recognition

THE BIER HAUS

Part I:

1. Identify the contract: The Bier Haus has entered into a verbal contract with the student to provide him with a beer in return for money.
2. Performance obligation: Bier Haus' performance obligation is to give the student his requested beer. The student's performance obligation is to give Bier Haus five dollars.
3. Transaction price: The total transaction price is five dollars.
4. Allocate transaction price to the performance obligation: When Bier Haus gives the student his beer they will have satisfied their performance obligation. In return, the student will give them five dollars; hence fulfilling his performance obligation.
5. Recognition of revenue: Bier Haus will instantaneously recognize revenue when they fulfill their performance obligation today.

DR: Cash	5	
CR: Sales Revenue		5

Part II:

1. Identify the contract: Bier Haus and the student enter into a verbal contract when each agrees exchange beer and a mug in return for money.

2. Performance obligation: Bier Haus has a performance obligation to give the student his beer and mug.
3. Transaction price: There is a seven-dollar total transaction price for the transaction.
4. Allocate transaction price to the performance obligation: Bier Haus will give the student his beer and mug. In return the student will give Bier Haus seven dollars. Because the student is getting multiple items for one price Bier Haus will need to allocate the price of each item towards the full seven-dollar amount.
    a. $4.38 allocated towards the cost of the beer
        i. $\left(\frac{5}{8}\right)(7) = 4.375$
    b. $2.63 allocated towards the cost of the mug
        i. $\left(\frac{3}{8}\right)(7) = 2.625$
5. Recognition of revenue: When Bier Haus satisfies their performance obligation today they will instantaneously recognize revenue. The following journal entry illustrates this.

    DR: Cash 7

    CR: Sales Revenue - beer 4.38

    CR: Sales Revenue - mug 2.62

Part III:

1. Identify the contract: There are multiple contracts in place with this transaction. Beir Haus has created a verbal contract with the student to provide him with a beer in return for money. Additionally, they have created a written contract with this same student for a future pretzel. Because Bier Haus is out of pretzels, they

agree to sell the student a coupon at a discounted rate. This written contract can be redeemed any date after the date of purchase.

2. Performance obligation: When the company gives the student his beer they will have completed their current performance obligation. Once they have served the student at a later date they will have fulfilled their second contract.
3. Transaction price: The student pays seven dollars today. The beer's price is five dollars and the pretzel's price is two dollars.
4. Allocate transaction price to the performance obligation: Bier Haus will allocate the full seven-dollar transaction price to their performance obligation, which was giving the student his beer. Five dollars will go towards the cost of the beer and the two-dollar coupon will be partial revenue.
5. Recognition of revenue: Recognition of revenue occurs when the performance obligation has been satisfied. Today, the beer company can recognize five dollars of revenue and they will have two dollars in unearned revenue until the students come to get his pretzel on a later day.

Journal entry for sale of beer:

DR: Cash 5

CR: Sales Revenue 5

Journal entry for pre-paid pretzel coupon:

DR: Cash 2

CR: Unearned Revenue 2

Part IV:

1. Identify the contract: The student will give Bier Haus a coupon and they will in turn give the student four dollars' worth of pretzels.
2. Performance obligation: Bier Haus has an obligation to give the student his pretzel.
3. Transaction price: $2 for a pre-paid pretzel coupon
4. Allocate transaction price to the performance obligation: Allocate the price when the student receives his pretzel and the company in turn receives the coupon.
5. Recognition of revenue: Bier Haus recognizes revenue when they satisfy their performance obligation. Because they had recognized unearned revenue for the pretzel coupon in part three they must now recognize their sales revenue for the two dollars. The following is their journal entry to record revenue.

DR: Unearned	2	
CR: Sales Revenue		2

Case 11: Deferred Taxes
ZAGG

A. Book income can also be referred to as pretax financial income or income before taxes or income for financial reporting purposes. This is the income companies determine before they account for their taxes. ZAGG's book income for fiscal 2012 was $23.898 million. A company's book income is determined using guidelines provided by GAAP, whereas their taxable income is determined after consulting the IRS' tax code. Taxable income has taken into consideration deductions and exemptions companies can take into consideration when calculating their taxable income.

B.

i. Permanent tax differences: "results from items that 1. Enter into pretax financial income but never into taxable income, or 2. Enter into taxable income but never into pretax financial income" (Kieso, Warfield, & Weygandt). An example of a permanent tax difference would be a company purchasing life insurance premiums for their employees.

ii. Temporary tax difference: "temporary differences that will result in taxable amounts in future years when the related assets are recovered" (Kieso, Warfield, & Weygandt). Examples of a temporary tax difference would be accrued liabilities, depreciation, and estimates.

iii. Statutory tax rate: The tax rate imposed by law. ZAGG's statutory tax rate is 35%.

iv. Effective tax rate: The percentage of income an individual actually pays in tax. This rate will always be lower than the statutory rate. Effective tax rate is an average rate. ZAGG's effective tax rate is 38%.

C. A company reports income taxes as part of their total income tax expense in order to provide their readers with a clear picture of their income tax expenses for the year. They do not report this current tax bill as their income tax expense because deferred income taxes are not the same as a company's total income tax so they cannot be combined into one entity. Many times companies defer those taxes until a later year and therefore they are not a current tax expense like traditional income taxes.

D. Deferred income tax asset is defined by Kieso, Warfield, and Weygandt as "the deferred tax consequence attributable to deductible temporary differences…a deferred tax asset represents the increase in taxes refundable (or saved) in future years as a result of deductible temporary differences existing at the end of the current year." An example of a deferred tax asset would be a company's refundable insurance premium. Deferred income tax liabilities can be defined as "the deferred tax consequences attributable to taxable temporary differences…a deferred tax liability represents the increase in taxes payable in future years as a result of taxable temporary differences existing at the end of the current year" (Kieso, Warfield, & Weygandt). Often times, companies keep separate books for financial and tax purposes. This can create a temporary difference between the

two books and often results in a deferred tax liability when the real tax payment is lower than the amount recorded by financial accounting.

E. Deferred income tax valuation allowance is an account created when the balance in the deferred asset account is greater than the expected benefit. This account is formed to reduce the balance sheet amount to the expected benefit value. A deferred income tax valuation account is a contra asset account that offsets the deferred tax benefit.

F. Note: Numbers stated in millions

i. Journal entry that ZAGG recorded for the income tax provision in fiscal 2012:

DR: Income Tax Expense	9.393	
DR: Net Deferred Tax Asset		8.293
CR: Income Tax Payable		17.686

ii. Decomposed amount of net deferred income taxes:

DR: Income Tax Expense		9.393
DR: Deferred Tax Asset	8.002	
DR: Deferred Tax Liability		.291
CR: Income Tax Payable		17.686

DTA increase: $8.002 (14.302-6.300)

DTL decrease $.292 ~ rounded to $.291 (.749-1.086)

iii. Effective tax rate = $\frac{Tax\ expense}{Pre-tax\ income}$

$\frac{9.393}{23.898} = .393 \sim 39.3\%$

Statutory rate (35%) x 23.897 = 8.364

iv. ZAGG had a net deferred income tax asset balance of $13.508 million at 12/31/2012. ZAGG's net deferred income tax asset balance of $13.508 million is broken up into current and noncurrent. The current portion of this can be found on the company's balance sheet as a deferred income tax asset valued at $6.912 million. The noncurrent portion of this net deferred income tax balance is located on the company's balance sheet as deferred income tax assets valued at $6.596 million.

Case 12: Leased Assets

BUILD-A-BEAR WORKSHOP

A. Companies lease assets instead of buy them because of the many advantages associated with leasing. Examples of these advantages are 100% financing at fixed rates, protection against obsolescence, flexibility, less costly financing, tax advantages, and off-balance-sheet financing (Kieso, Warfield, & Weygandt).

B.

- An operating lease: is created when the owner transfers only the right to use the property. At the end of the lease, the lessee returns the property to its owner. The lessee assumes no ownership risk and their lease expense is treated an operating expense on their income statement.
- Capital lease: lets the lessee assume some of the ownership risk and some of the property's benefits. When signed, the lease is recognized as both an asset and liability on the balance sheet.
- Direct financing lease: is an arrangement in which the lessor (owner) buys assets and leases them to customers. The lessor recognizing the gross investment in the lease and the related amount of unearned income.
- Sales type lease: when the fair value of a leased property is different from its carrying value, there is a transfer of ownership upon the end of the lease, and real estate is involved, the lessor classifies the lease as a sales type. Often times firms lease their own equipment and create a sale type lease to do so.

C. Distinguishing between the different types of leases aid financial users in comparing firms and analyzing their own. This gives them a more relevant and reliable view of a particular company. Accountants make sure to distinguish between the varying types of leases for this reason.

D.

i. Build-A-Bear Workshop's lease will be treated as an operating lease.

ii. Journal entry that Build-A-Bear Workshop will record when it makes the first lease payment:

DR: Lease Expense	100,000	
CR: Cash		100,000

iii.

<u>First Year of "first year rent-free":</u>

DR: Rent Expense	100,000	
CR: Deferred Rent		100,000

<u>Years 2-5:</u>

DR: Rent Expense	100,000		
DR: Deferred Rent	25,000		
CR: Cash			125,000

E.

i. Build-A-Bear Workshop reported $45.9 million dollars' worth of rent expense on operating leases in fiscal 2009.

ii. This number was reported in the company's operating expense section of their income statement in fiscal 2009.

F.

i. Present value of the future minimum lease payments at January 2, 2010. Assuming an interest rate of 7% for the leases:

Period	PYMTS	PVF	PV
1	50,651.00	0.9346	47,337.38
2	47,107.00	0.8734	41,145.08
3	42,345.00	0.8163	34,566.13
4	35,469.00	0.7629	27,059.13
5	31,319.00	0.7130	22,330.01
6	25,229.00	0.6663	16,811.15
7	25,229.00	0.6227	15,711.35
8	25,229.00	0.5820	14,683.51
			219,643.75

ii. Journal entry Build-A-Bear Workshop would have recorded had they entered into all of these leases on January 2,2010 and considered them capital leases:

DR: Property & Equipment	219,643.75	
CR: Lease Obligation		219,643.75

v. Journal entries recorded in fiscal 2010 capital leases:

<u>Interest expense & lease payment:</u>

DR: Lease Obligation	15,375.06	
DR: Interest Expense	35,275.94	
CR: Cash		50,651

*lease obligation = 219,643.75 X 7%

<u>Amortization of leased asset:</u>

DR: Depreciation Expense	27,455.47	
CR: Accumulated Depreciation		27,455.47

*depreciation expense = 219,643.75/8years

G. Under current U.S. GAAP, Build-A-Bear Workshop's management has incentives to structure its leases as operating leases. They do not report depreciation on their statements and their lease expense is treated as an operating expense and the lease is not included as part of the capital of the firm.

H.

i. Comparing and contrasting how capitalizing a lease effects a company's key ratios can be extremely helpful when analyzing how effective capitalizing is on the overall company. Current assets will not change when the company chooses to capitalize their leases because the debit to property, plant, and equipment will be a long-term asset. Current liabilities will change due to capitalizing because the lease's liability will have a current portion due within the year. Build-A-Bear's debt-to-equity ratio will change slightly due to capitalizing. Debt-to-equity is defined as total liabilities divided by stockholder's equity. Liabilities will be increasing and stockholder's equity will be unaffected by capitalization which will cause this ratio to increase. Another important ratio to consider is a company's long term debt-to-assets ratio which is defined as long term debt divided by total assets. Through capitalization, both assets and liabilities are being increased at the beginning of the lease and slowly decreased over the useful life. Because both are increases at the start of the lease, the new ratio should increase slightly. The decision to capitalize leases will not always yield weaker liquidity and solvency ratios. This is because it will depend on the increase in net income, net liabilities, and net assets. The table below illustrates the ratios discussed above.