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ALTERNATIVE ACCOUNTING THESIS: SPECIAL TOPICS

by
Kenneth Edward Starling III

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, Mississippi
May 2018

Approved by

____

Advisor: Professor Vicki Dickinson

____

Reader: Dean Mark Wilder

ABSTRACT

The following case studies represent the end result of my Accounting 420 class. The Patterson School of Accountancy provided an alternative thesis route that involved speakers from recruiters and case studies. While this thesis is the physical output on my year long course, the case studies do not close to encapsulating everything I learned in Dr. Dickinson's alternative thesis course. I was able to completely delve into the accounting topics. The loose structure of assignment allowed my classmates and myself to understand the cases much more completely as there were multiple approaches available.

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Glenwood Heating, Inc & Eads Heater, Inc.

Prepared by: Kent Starling

September 07, 2016

“On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report.”

EXECUTIVE SUMMARY

Objective

I prepared this summary with the objective of comparing two similar heating companies, Glenwood Heating, Inc. and Eads Heater, Inc. in order to recognize the differences between them. Using the differences, I am able to provide a more complete recommendation for which company I feel would be the best investment. Glenwood Inc. is the best investment opportunity due to several factors including: profit margin, return on assets, and earnings per share.

ANALYSIS

The profit margin ratio measures the profitability of a company, and it is the company's net income divided by the sales of the company. Glenwood Heating, Inc. has a net income of $92,742 and total sales of $398,500 which is a profit margin ratio of 23.27%. Eads Heater, Inc. has a net income of $70,515 and sales totaling $398,500 which is a profit margin of 17.7%. Glenwood Heating, Inc. has a significantly higher profit margin. While profit margin can often be a misleading statistic, it was not the only factor in my decision, but it did play a strong role.

The return on assets (ROA) ratio is a measurement of how profitable a company is compared with their total assets. ROA is calculated by taking a company's net income and dividing it by total assets. Glenwood Heating, Inc. has a net income of $92,742 and total assets equalling $642,632 which is a ROA of 14.4%. Eads Heater, Inc. has a net income of $70,515 and total assets of $703,765 which is a ROA of 10%. Glenwood Heating, Inc. has a higher return on assets which

FINANCIAL ANALYSIS

shows that they are using their assets in an efficient manner when compared with Eads Heater, Inc.

A company's earning per share is the amount of the company's profit per each share of outstanding stock. It is calculated by taking a company's net income and dividing it by the average outstanding shares during that period. Glenwood Heating, Inc. has a net income of $92,742 with 3,200 shares issued in their first year of operation. This results in an earning per share of $28.98. Eads Heater, Inc has a net income of $70,515 with the same 3,200 shares outstanding which gives them an earning per share of $22.03. While it is typically helpful to look at the trend of the earnings per share, both companies are in their first year. Glenwood Heating, Inc. has the more favorable earning per share which is another factor in my decision that they are the better investment opportunity.

Home Heaters

Part A: Recording Basic Transactions

	Transaction:	1	2	3	4	5	6	7	8	9	10	11	12	Total
Assets														
	Cash	160,000	400,000	-420,000	-80,000			299,100	-213,360	-41,000	-34,200	-23,200		47,340
	Accounts Recievable						398,500	-299,100						99,400
	Allowance for Bad Debts													0
	Inventory					239,800								239,800
	Land			70,000										70,000
	Building			350,000										350,000
	Acc Dep Building													0
	Equipment				80,000									80,000
	Acc Dep Equipment													0
	Leased Equipment													0
	Acc Dep Leased Equip													0
														0
Liabilities														0
	Accounts Payable					-239,800			213,360					-26,440
	Interest Payable												-6650	-6,650
	Note Payable		-400,000							20,000				-380,000
	Lease Payable													0
														0
Equity														0
	Common Stock	-160,000												-160,000
	Retained Earnings													0
	Dividends											23,200		23,200
	Sales						-398,500							-398,500
	Cost of Goods Sold													0
	Bad Debt Expense													0
	Depreciation Expense													0
	Interest Expense									21,000			6650	27,650
	Other Operating Expenses										34,200			34,200
	Rent Expense													0
	Provision for Income Taxes													0

Home Heaters

Trial Balance -- Part A

		Debits	Credits
Cash		47,340	
Accounts Receivable		99,400	
Inventory		239,800	
Land		70,000	
Building		350,000	
Equipment		80,000	
Accounts Payable			26,440
Note Payable			380,000
Interest Payable			6650
Common Stock			160,000
Dividend		23,200	
Sales			398,500
Other Operating Exp		34,200	
Interest Exp		27,650	
Total		971,590	971,590

Glenwood Heating, Inc.									
Part B: Recording Additional Information									
	Decisions	Beg Balance	1. Bad Debt	2. COGS	3. Building Dep	3. Equip Dep	4. Equip Rental Payment	5. Income Tax	Balances
Assets									
	Cash	47,340					-16,000	-30,914	426
	Accounts Recievable	99,400							99,400
	Allowance for Bad Debts	0	-994						-994
	Inventory	239,800		-177,000					62,800
	Land	70,000							70,000
	Building	350,000							350,000
	Acc Dep Building	0			-10,000				-10,000
	Equipment	80,000							80,000
	Acc Dep Equipment	0				-9,000			-9,000
	Leased Equipment	0							0
	Acc Dep Leased Equip	0							0
Liabilities		0							0
	Accounts Payable	-26,440							-26,440
	Interest Payable	-6,650							-6,650
	Note Payable	-380,000							-380,000
	Lease Payable	0							0
Equity		0							
	Common Stock	-160,000							-160,000
	Retained Earnings	0							0
	Dividends	23,200							23,200
	Sales	-398,500							-398,500
	Cost of Goods Sold	0		177,000					177,000
	Bad Debt Expense	0	994						994
	Depreciation Expense	0			10,000	9,000			19,000
	Interest Expense	27,650							27,650
	Other Operating Expenses	34,200							34,200
	Rent Expense	0					16,000		16,000
	Provision for Income Taxes	0						30,914	30,914

Glenwood Heating, Inc.		
Trial Balance -- Part A		
	Debits	Credits
Cash	426	
Accounts Recievable	99,400	
Allowance for Bad Debts		994
Inventory	62,800	
Land	70,000	
Building	350,000	
Acc Dep Building		10,000
Equipment	80,000	
Acc Dep Equipment		9,000
Leased Equipment	0	
Acc Dep Leased Equip	0	
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		
Common Stock		160,000
Retained Earnings	0	
Dividends	23,200	
Sales		398,500
Cost of Goods Sold	177,000	
Bad Debt Expense	994	
Depreciation Expense	19,000	
Interest Expense	27,650	
Other Operating Expenses	34,200	
Rent Expense	16,000	
Provision for Income Taxes	30,914	
Total	991,584	991,584

Glenwood Heating, Inc			
Income Statement			
For the Year Ended Dec 31, 20x1			
Sales			398,500
Cogs			-177000
Gross Profit			221,500
Operating Exp			
	Bad Debt Exp	994	
	Depreciation Exp	19,000	
	Other Operating Exp	34,200	
	Rent Exp	16,000	
Total Operating Exp			-70194
Income From Operations			151,306
	Interest Exp		-27650
Income Before Tax			123,656
	Provision for Income Tax		-30914
Net Income			92,742

Glenwood Heating, Inc.					
Classified Balance Sheet					
For the Year Ended Dec 31, 20X1					
Assets					
	Current Assets				
		Cash	426		
		Accounts Recievable	99,400		
		Allowance for Bad Debts	-994		
		Inventory	62,800		
		Total Current Assets		161,632	
	Property, Plant, Equipment				
		Land	70,000		
		Building	350,000		
		Equipment	80,000		
		Leased Equipment	0		
		Total PPE	500,000		
	Less: Acc Dep				
		Acc Dep Equipment	10,000		
		Acc Dep Building	9,000		
		Acc Dep Leased Equip	0		
	Total		19,000	481,000	
	Total Assets				642,632
Liabilities					
	Current Liabilities				
		Accounts Payable	26,440		
		Interest Payable	6,650		
		Lease Payable	0		
	Total Current Liabilities			33,090	
	Longterm Liabilities				
		Note Payable	380,000		
Total Longterm Liabilities				380,000	
Total Liabilities					413,090
Equity					
		Common Stock	160,000		
		Retained Earnings	69,542		
Total Equity					229,542
Total Liab and Equip					642,632

Glenwood Heating, Inc.		
Statement of Retained Earnings		
For the Year Ended December 31, 20X1		
Beginning RE Balance		0
Net Income		92,742
Dividends		23,200
Ending RE Balance		69,542

Glenwood Heating, Inc.		
Statement of Cash Flows (Indirect Approach)		
For The Year Ending Dec, 31, 20X1		
CFs from Operating		
	Net Income	92,742
	Accounts Receivable	-99,400
	Inventory	-62,800
	Accounts Payable	26,440
	Interest Payable	6,650
	Dep Expense	19,000
	Bad Debt Exp	994
Net Cash From Operating		-16,374
CFs from Investing		
	Land	-70,000
	Building	-350,000
	Equipment	-80,000
Net Cash From Investing		-500,000
CFs from Financing		
	Common Stock	160,000
	Dividends	-23,200
	Notes Payable	380,000
Net Cash From Financing		516,800
Net Cash Provided		426

Eads Heater, Inc.

Part B: Recording Additional Information

	Decisions	Beg Balance	1. Bad Debt	2. COGS	3. Building Dep	3. Equip Dep	4. Equip Rental Payment	5. Income Tax	Balances
Assets									
	Cash	47,340					-16,000	-23,505	7,835
	Accounts Recievable	99,400							99,400
	Allowance for Bad Debts	0	-4,970						-4,970
	Inventory	239,800		-188,800					51,000
	Land	70,000							70,000
	Building	350,000							350,000
	Acc Dep Building	0			-10,000				-10,000
	Equipment	80,000							80,000
	Acc Dep Equipment	0				-20,000			-20,000
	Leased Equipment	0					92,000		92,000
	Acc Dep Leased Equip	0					-11,500		-11,500
									0
Liabilities		0							0
	Accounts Payable	-26,440							-26,440
	Interest Payable	-6,650							-6,650
	Note Payable	-380,000							-380,000
	Lease Payable	0					-83,360		-83,360
									0
Equity		0							0
	Common Stock	-160,000							-160,000
	Retained Earnings	0							0
	Dividends	23,200							23,200
	Sales	-398,500							-398,500
	Cost of Goods Sold	0		188,800					188,800
	Bad Debt Expense	0	4,970						4,970
	Depreciation Expense	0			10,000	20,000	11,500		41,500
	Interest Expense	27,650					7,360		35,010
	Other Operating Expenses	34,200							34,200
	Rent Expense	0							0
	Provision for Income Taxes	0						23,505	23,505

Eads Heater, Inc.		
Trial Balance -- Part A		
	Debits	Credits
Cash	7,835	
Accounts Recievable	99,400	
Allowance for Bad Debts		4,970
Inventory	51,000	
Land	70,000	
Building	350,000	
Acc Dep Building		10,000
Equipment	80,000	
Acc Dep Equipment		20,000
Leased Equipment	92,000	
Acc Dep Leased Equip		11,500
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		83,360
Common Stock		160,000
Retained Earnings	0	
Dividends	23,200	
Sales		398,500
Cost of Goods Sold	188,800	
Bad Debt Expense	4,970	
Depreciation Expense	41,500	
Interest Expense	35,010	
Other Operating Expenses	34,200	
Rent Expense	0	
Provision for Income Taxes	23,505	
Total:	1,101,420	1,101,420

Eads Heater, Inc

Income Statement

For the Year Ended Dec 31, 20x1

Sales			398,500
Cogs			-188800
Gross Profit			209,700
Operating Exp			
	Bad Debt Exp	4,970	
	Depreciation Exp	41,500	
	Other Operating Exp	34,200	
	Rent Exp	0	
Total Operating Exp			-80670
Income From Operations			129,030
	Interest Exp		-35010
Income Before Tax			94,020
	Provision for Income Tax		-23505
Net Income			70,515.00

Eads Heater, Inc.		
Statement of Retained Earnings		
For the Year Ended December 31, 20X1		
Beginning RE Balance		0
Net Income		70,515
Dividends		23,200
Ending RE Balance		47,315

Eads Heater Inc.		
Statement of Cash Flows (Indirect Approach)		
For The Year Ending Dec, 31, 20X1		
CFs from Operating		
	Net Income	70,515
	Accounts Receivable	-99,400
	Inventory	-51,000
	Accounts Payable	26,440
	Interest Payable	6,650
	Dep Expense	41,500
	Bad Debt Exp	4,970
Net Cash From Operating		-325
CFs from Investing		
	Land	-70,000
	Building	-350,000
	Equipment	-80,000
Net Cash From Investing		-500,000
CFs from Financing		
	Common Stock	160,000
	Dividends	-23,200
	Notes Payable	380,000
	Lease Payable	83,360
Net Cash From Financing		600,160
Net Cash Provided		99,835

CASE 2

Totz, Inc.

Prepared by: Kent Starling

September 21, 2016

"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

1. Net Sales

The $86.5 million in net sales during 2016 will be in the income statement, but because of rule 225-10-S99-2-1, the net sales will have to be broken up between Totz and Doodlez. This SEC rule section states that if services revenues is under 10% of net income, it can be combined with another class. Since Doodlez sales in 2015 is under 10%, it was not required to be separated under this SEC rule. Doodlez's service revenue has increased to 11.2 million, so it is now required to put in separate revenues and expenses. The $75.3 million from Totz's sales will go into the operating section under sales; whereas, the revenue of $11.3 million from Doodlez will have to be separated out in the service revenue section.

2. Gross Profit

Similar to the handling of net sales, the cost of sales must be separated between sales and services. The cost of sales from Totz would go in the operating section under cost of goods sold, and the service costs incurred by Doodlez would go under cost of services provided. ACS-605-10-S99-1 states that, "gains or losses from the sale of assets should be reported as 'other general expense'… Any material item should be stated separately."This separation allows users to distinguish between the differences in costs and gross profit between Totz and Doodlez, and it is required by SEC rule 225-10-S99-2-2. The cost of sales and services would be subtracted from sales and service revenue in order to get the total gross profit. Toto should not report a gross profit subtotal because the excluded depreciation is attributable to cost of sales.

3. Gain on Sale of Corporate Headquarters

The sale of the abandoned corporate headquarters would go into the non-operating section of the income statement. The $1.7 million would go into the other revenues and gains section. Since it is not a gain generated by the normal operations of the business, it would not go into the operating section. ASC 360-10-45-5 discusses how to handle the presentation of disposal gains or losses in continuing operations. This is why the gain from the sale will go into the other revenues and gains in the non-operating section. ACS-605-10-S99-1 states that, "gains or losses from the sale of assets should be reported as 'other general expense'… Any material item should be stated separately."The reason it is a continuing operation is because Totz is still in business; the headquarters has just been relocated.

4. Class Action Settlement

The gain from the class action settlement should be recorded in the non-operating section of the income statement. Since the case has been settled, Totz, Inc. is able to recognize the contingent gain. It is a gain that is related to the usual activities of the business; therefore, it should be placed in the other revenues and gains in the operating section. ASC 605-10-S99-1 indicates that the SEC believes the guidance in Reg S-X Rule 5-03(b)(6) applies to both gains and losses. The $2.7 million in class action settlement will go under the gains in the operating section.

		1. Purchase Inventory	2. Incur Factory Wages	3. Sell Inventory for Cash and on account	4. Pay for Inventory	5. Collect Receivables	6. Incur SG&A(Cash and payable)	7. Pay Wages	8. Receivable Franchise Fee	9. Purchase PPE	10. Dividends declared and paid	11. All other transactions	Unadjusted Trial Balance
Cash	$ 1,253,947.00			$ 17,000,000.00	-$8,200,000.00	$ 4,100,000.00	-$ 2,000,000.00	-$6,423,789.00	$125,000.00	-$498,832.00	-$ 2,403,458.00	$ 790,224.00	$ 3,743,092.00
Accounts Receivable	$ 4,229,733.00			$ 5,000,000.00		-$4,100,000.00						-$ 702,207.00	$ 4,427,526.00
Notes Receivable	$ -											$ 91,059.00	$ 91,059.00
Inventories	$ 4,064,611.00	$ 7,500,000.00	$6,000,000.00	-$ 14,000,000.00								-$ 66,328.00	$ 3,498,283.00
Deferred Income Tax	$ 369,197.00											$ 92,052.00	$ 461,249.00
Other	$ 224,378.00											-$ 4,215.00	$ 220,163.00
Property and Equipment	$ 5,253,598.00									$ 498,832.00		$ 132,859.00	$ 5,885,289.00
Notes Receivable less current portion	$ 124,452.00											$ 139,198.00	$ 263,650.00
Goodwill	$ 1,046,944.00											$ -	$ 1,046,944.00
Intangible Assets	$ 183,135.00											-$ 73,110.00	$ 110,025.00
Other	$ 91,057.00											-$ 3,007.00	$ 88,050.00
Accounts Payable	$ 1,074,643.00	$ 7,500,000.00			-$8,200,000.00							$ 503,189.00	$ 877,832.00
Accrued Salaries and Wages	$ 423,789.00		$6,000,000.00					-$6,423,789.00				$ -	$ -
Other accrued exp	$ 531,941.00						$ 3,300,000.00					-$2,885,413.00	$ 946,528.00
Dividend Payable	$ 598,986.00										$ 3,709.00	-$ 1.00	$ 602,694.00
Deferred Income	$ 142,000.00								$125,000.00			-$ 46,062.00	$ 220,938.00
Deferred Income Taxes	$ 827,700.00											$ 66,729.00	$ 894,429.00
Common Stock	$ 179,696.00											$ 1,112.00	$ 180,808.00
Additional Paid-in capital	$ 7,311,280.00											$ 315,322.00	$ 7,626,602.00
Retained Earnings	$ 5,751,017.00										-$ 2,407,167.00	$ -	$ 3,343,850.00
Sales	$ -			$ 22,000,000.00								$ 944,017.00	$22,944,017.00
Franchise and Royalty Fees	$ -											$ 5,492,531.00	$ 5,492,531.00
Cost of Sales	$ -			$ 14,000,000.00								$ 693,786.00	$14,693,786.00
Franchise Cost	$ -											$ 1,499,477.00	$ 1,499,477.00
Sales & Marketing	$ -						$ 1,505,431.00					$ -	$ 1,505,431.00
General and Admin	$ -						$ 2,044,569.00					-$ 261,622.00	$ 1,782,947.00
Retail Operating	$ -						$ 1,750,000.00					$ -	$ 1,750,000.00
Depreciation and Amortization	$ -											$ -	$ -
Interest Income	$ -											-$ 27,210.00	-$ 27,210.00
Income Tax Expense	$ -											$ 2,090,468.00	$ 2,090,468.00
Cash Flow Transaction Classification		Operating	Operating	Operating	Operating	Operating	Operating	Operating	Operating	Investing	Financing		

		1. Purchase Inventory	2. Incur Factory Wages	3. Sell Inventory for Cash and on account	4. Pay for Inventory	5. Collect Receivables	6. Incur SG&A(Cash and payable)	7. Pay Wages	8. Receivable Franchise Fee	9. Purchase PPE	10. Dividends declared and paid	11. All other transactions	Unadjusted Trial Balance
Cash	$ 1,253,947.00			$ 17,000,000.00	-$ 8,200,000.00	$ 4,100,000.00	-$ 2,000,000.00	-$ 6,423,789.00	$125,000.00	-$ 498,832.00	-$ 2,403,458.00	$ 790,224.00	$ 3,743,092.00
Accounts Receivable	$ 4,229,733.00			$ 5,000,000.00		-$ 4,100,000.00						-$ 702,207.00	$ 4,427,526.00
Notes Receivable	$ -											$ 91,059.00	$ 91,059.00
Inventories	$ 4,064,611.00	$ 7,500,000.00	$ 6,000,000.00	-$ 14,000,000.00								-$ 66,328.00	$ 3,498,283.00
Deferred Income Tax	$ 369,197.00											$ 92,052.00	$ 461,249.00
Other	$ 224,378.00											-$ 4,215.00	$ 220,163.00
Property and Equipment	$ 5,253,598.00									$ 498,832.00		$ 132,859.00	$ 5,885,289.00
Notes Receivable less current portion	$ 124,452.00											$ 139,198.00	$ 263,650.00
Goodwill	$ 1,046,944.00											$ -	$ 1,046,944.00
Intangible Assets	$ 183,135.00											-$ 73,110.00	$ 110,025.00
Other	$ 91,057.00											-$ 3,007.00	$ 88,050.00
Accounts Payable	$ 1,074,643.00	$ 7,500,000.00			-$ 8,200,000.00							$ 503,189.00	$ 877,832.00
Accrued Salaries and Wages	$ 423,789.00		$ 6,000,000.00					-$ 6,423,789.00				$ -	$ -
Other accrued exp	$ 531,941.00						$ 3,300,000.00					-$ 2,885,413.00	$ 946,528.00
Dividend Payable	$ 598,986.00										$ 3,709.00	-$ 1.00	$ 602,694.00
Deferred Income	$ 142,000.00								$125,000.00			-$ 46,062.00	$ 220,938.00
Deferred Income Taxes	$ 827,700.00											$ 66,729.00	$ 894,429.00
Common Stock	$ 179,696.00											$ 1,112.00	$ 180,808.00
Additional Paid-in capital	$ 7,311,280.00											$ 315,322.00	$ 7,626,602.00
Retained Earnings	$ 5,751,017.00										-$ 2,407,167.00	$ -	$ 3,343,850.00
Sales	$ -			$ 22,000,000.00								$ 944,017.00	$ 22,944,017.00
Franchise and Royalty Fees	$ -											$ 5,492,531.00	$ 5,492,531.00
Cost of Sales	$ -			$ 14,000,000.00								$ 693,786.00	$ 14,693,786.00
Franchise Cost	$ -											$ 1,499,477.00	$ 1,499,477.00
Sales & Marketing	$ -						$ 1,505,431.00					$ -	$ 1,505,431.00
General and Admin	$ -						$ 2,044,569.00					-$ 261,622.00	$ 1,782,947.00
Retail Operating	$ -						$ 1,750,000.00					$ -	$ 1,750,000.00
Depreciation and Amortization	$ -											$ -	$ -
Interest Income	$ -											-$ 27,210.00	-$ 27,210.00
Income Tax Expense	$ -											$ 2,090,468.00	$ 2,090,468.00
Cash Flow Transaction Classification		Operating	Operating	Operating	Operating	Operating	Operating	Operating	Operating	Investing	Financing		

Rocky Mountain Chocolate Factory		
Income Statement		
Year Ended February 28, 2010		
Revenues		
Sales	22,944,017.00	
Franchise and Royalty Fees	5,492,531.00	
Total Revenues		28,436,548.00
Costs and Expense		
Cost of Sales	14,910,622.00	
Franchise Cost	1,499,477.00	
Sales & Marketing	1,505,431.00	
General and Admin	2,422,147.00	
Retail Operating	1,756,956.00	
Depreciation and Amortization	698,580.00	
Total Costs and Expenses		22,793,213.00
Operating Income		5,643,335.00
Other Income(Expense)		
Interest Income	- 27,210.00	
		- 27,210.00
Income Before Tax		5,670,545.00
Income Tax Expense	2,090,468.00	
		2,090,468.00
Net Income		$ 3,580,077.00
Basic Earnings per Common Stock	$ 0.60	
Diluted Earnings per Common Stock	$ 0.58	
Weighted Average C/S Outstanding	6,012,717	
Dilutive effect of Employee Stock Option	197,521	
Weighted Average C/S Outstanding, Assuming Dilution	6,210,238	

	Unadjusted Trial Balance	12. Adjust for Inv Cont	13. Record Dep	14. Wage Accrual	15. Consultant's Report	Pre-closing Trial Balance	16. Closing Entry	Post-Closing (Ending) Balance	Actual February 28, 2010 F/S figures
Cash	$ 3,743,092.00					$ 3,743,092.00		$ 3,743,092.00	$ 3,743,092.00
Accounts Receivable	$ 4,427,526.00					$ 4,427,526.00		$ 4,427,526.00	$ 4,427,526.00
Notes Receivable	$ 91,059.00					$ 91,059.00		$ 91,059.00	$ 91,059.00
Inventories	$ 3,498,283.00	-$ 216,836.00				$ 3,281,447.00		$ 3,281,447.00	$ 3,281,447.00
Deferred Income Tax	$ 461,249.00					$ 461,249.00		$ 461,249.00	$ 461,249.00
Other	$ 220,163.00					$ 220,163.00		$ 220,163.00	$ 220,163.00
Property and Equipment	$ 5,885,289.00		-$ 698,580.00			$ 5,186,709.00		$ 5,186,709.00	$ 5,186,709.00
Notes Receivable less current portion	$ 263,650.00					$ 263,650.00		$ 263,650.00	$ 263,650.00
Goodwill	$ 1,046,944.00					$ 1,046,944.00		$ 1,046,944.00	$ 1,046,944.00
Intangible Assets	$ 110,025.00					$ 110,025.00		$ 110,025.00	$ 110,025.00
Other	$ 88,050.00					$ 88,050.00		$ 88,050.00	$ 88,050.00
Accounts Payable	$ 877,832.00					$ 877,832.00		$ 877,832.00	$ 877,832.00
Accrued Salaries and Wages	$ -			$ 646,156.00		$ 646,156.00		$ 646,156.00	$ 646,156.00
Other accrued exp	$ 946,528.00					$ 946,528.00		$ 946,528.00	$ 946,528.00
Dividend Payable	$ 602,694.00					$ 602,694.00		$ 602,694.00	$ 602,694.00
Deferred Income	$ 220,938.00					$ 220,938.00		$ 220,938.00	$ 220,938.00
Deferred Income Taxes	$ 894,429.00					$ 894,429.00		$ 894,429.00	$ 894,429.00
Common Stock	$ 180,808.00					$ 180,808.00		$ 180,808.00	$ 180,808.00
Additional Paid-in capital	$ 7,626,602.00					$ 7,626,602.00		$ 7,626,602.00	$ 7,626,602.00
Retained Earnings	$ 3,343,850.00					$ 3,343,850.00	$ 3,580,077.00	$ 6,923,927.00	$ 6,923,927.00
Sales	$ 22,944,017.00					$ 22,944,017.00	-$ 22,944,017.00	$ -	$ 22,944,017.00
Franchise and Royalty Fees	$ 5,492,531.00					$ 5,492,531.00	-$ 5,492,531.00	$ -	$ 5,492,531.00
Cost of Sales	$ 14,693,786.00	$ 216,836.00				$ 14,910,622.00	-$ 14,910,622.00	$ -	$ 14,910,622.00
Franchise Cost	$ 1,499,477.00					$ 1,499,477.00	-$ 1,499,477.00	$ -	$ 1,499,477.00
Sales & Marketing	$ 1,505,431.00					$ 1,505,431.00	-$ 1,505,431.00	$ -	$ 1,505,431.00
General and Admin	$ 1,782,947.00			$ 639,200.00		$ 2,422,147.00	-$ 2,422,147.00	$ -	$ 2,422,147.00
Retail Operating	$ 1,750,000.00			$ 6,956.00		$ 1,756,956.00	-$ 1,756,956.00	$ -	$ 1,756,956.00
Depreciation and Amortization	$ -		$ 698,580.00			$ 698,580.00	-$ 698,580.00	$ -	$ 698,580.00
Interest Income	-$ 27,210.00					-$ 27,210.00	$ 27,210.00	$ -	-$ 27,210.00
Income Tax Expense	$ 2,090,468.00					$ 2,090,468.00	-$ 2,090,468.00	$ -	$ 2,090,468.00
Cash Flow Transaction Classification		Operating	Operating	Operating					

Property and Equipment		5,186,709.00
Other Assets		
	Notes Receivable less current portion	263,650.00
	Goodwill	1,046,944.00
	Intangible Assets	110,025.00
	Other	88,050.00
	Total Other Assets	1,508,669.00
	Total Assets	$ 18,919,914.00
Liabilities and Stockholders' Equity		
Current Liabilities		
	Accounts Payable	877,832.00
	Accrued Salaries and Wages	646,156.00
	Other accrued exp	946,528.00
	Dividend Payable	602,694.00
	Deferred Income	220,938.00
	Total Current Liabilities	3,294,148.00
Deferred Income Tax		894,429.00
Commitments and Contingencies		-
Stockholders' Equity		
	Common Stock	180,808.00
	Additional Paid-in capital	7,626,602.00
	Retained Earnings	6,923,927.00
	Total SE	14,731,337.00
	Total Liabilities and Stockholders' Equity	$ 18,919,914.00

CASE 5

Inventory Impairment

Prepared by: Kent Starling

November 02, 2016

"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

1.

a. Raw Material are the costs associated with goods and materials that have not been used yet.

b. Work in progress are the materials that are required to finish unfinished goods.

c. Finished Goods include the costs for complete but unsold goods.

2.

Inventory is recorded net of an estimated allowance for obsolete or unmarketable inventory. The allowance serves as a contra account against the inventory account. If it is able to be reasonably estimated that a certain percentage of the inventory is defective or returned, it is included in the contra inventory account.

3.

a. This account appears in the current asset account in the balance sheet. It serves as a contra asset taking away the obsolete or unmarketable inventory from the balance.

b. December 31, 2011: $233,070 + $10,800 = $243,870

December 31, 2012: $211,734 + $12,520 = $224,254

c. In 2011 and 2012, the largest inventory balance was from finished goods. At the end of the month, the manufacturing company has finished most of the goods they have in process. The company has a strong amount of remaining safety raw materials.

4.

Obsolete or Unmarketable Inventory Expense	$13,348	
	Allowance for Obsolete or Unmarketable Inventory	$13,348
Allowance for Obsolete or Unmarketable Inventory	$11,628	
	Inventory	$11,628

5.

Raw Material		WIP	
$46,469		$1,286	
$578,009	$3,000	$126,000	$582,083
	$126,000	$455,416	
	$455,416		
$43,469		$619	

Finished Good Inventory		Cost of Sales	
$184,808		0	
$582,083	$13,348	$13,348	
	$585,897	$572,549	
$167,646		$585,897	

Accounts Payable	
	$39,012
$571,645	$578,009
	$45,376

Account	Balance
Cost of Finished Goods Sold	$585,897
Cost of Goods Manufactured	$581,416
Cost of Raw Materials Transferred to WIP	$455,416
Cost of Raw Materials Puchased	$578,009
Cash Disbursed for Raw Materials Purchases	$571,645

6. Inventory Turnover Ratio

2011: $575,226 / (($268,591 + $233,070) / 2) = 2.29 times

2012: $585,897 / (($233,070 +211,734) / 2) = 2.63 times

7. Inventory Holding Period

2011: 365 / 2.29 = 159.389 days

2012: 365 /2.63 = 138.78 days

The manufacturing company has become more efficient which is shown through the decrease in the holding period of inventory and the inventory turnover ratio. They are able to hold less

inventory at any point in time and still get the needed products to the correct places efficiently.

8. Reserve for Obsolete Inventory

2011: 13,348 / 184,808= 7.22%

2012: 13,348 / 167,646= 7.96%

As an investor, I would like to know more about the culture of the leadership and the employee turnover. A company could look very promising on paper, but in reality, it could be ran very poorly. Corporate culture starts at the top, so by meeting with the leaders of the company, I would be able to gain a strong understanding of what the company is about.

University of Mississippi

Patterson School of Accountancy

Potential Fraud Schemes and Internal Controls

Prepared by:
Darby Mills
Sarah Catherine Thornton
Kent Starling
Elizabeth Clutton
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Accy 420
October, 19, 2016

Fraud Schemes:

Potential Fraud Scheme	Internal Control
The store only has one credit card machine located in between the two cash registers.	Documentation - Transactions could get mixed up between the two cash registers: have a credit card machine for each cash register. Running two different purchases at the same time could allow for an employee to steal money: have proper documentation for theft prevention. If the credit card machine fails, there is no way to track transactions/ inflow or outflow of money: have an alternate system of documentation in addition to the credit card machine and two cash registers.
Every single employee has their own access code to both registers, increasing the risk of possible errors or discrepancies during transactions.	Access Controls - Limit the number of workers with access to the registers and/or assign employees to certain registers that they can use. Check the accounting software to identify any variances under specific users.
Employees can steal inventory.	Physical Audits - The store should perform a physical inventory count once a month (or after a certain period of time) and compare physical inventory with recorded inventory.
Employees could alter the amount of cash removed from the cash registers so that the amount of money on the receipts and the amount removed from the register do not match up.	Reconciliations - Reconcile the register tape with the store sales receipts. The amount of cash and credit sales should equal the amount of the register and store sales receipts. Also take a physical count of money totals in each cash register at the end of each day.
Lucy has the ability to incorrectly record the daily sales and take money from the register.	Separation of Duties - One employee should monitor Lucy while she records daily sales. Another employee should evaluate Lucy's documentation for any errors. Alternatively, one employee should record the sales and another employee should prepare the bank deposits.

Electronic cash registers could be hacked from an outside source. No employee has a key to the register, leaving it vulnerable to outside access.	Access Controls - More security is required for the cash registers. Additional passwords and theft protection software is needed. Lucy and Kayla should have keys to the registers for managerial duties. Each time one of them opens a register, another employee must be present to monitor their activity.
Lucy has the ability to steal from the store when dealing with small customer issues. She is able to falsify refunds for customers that do not exist.	Separation of Duties - One employee should deal with the customer issue while another employee issues the refund or new product.
Because the clerks have full authority to perform all types of transactions, they are able to create fake returns and steal money from the register.	Physical Audits - Performing regular physical inventory examinations would help prevent employees from stealing from the store. Only authorize certain employees to perform certain transactions.
Every single employee works on Saturday; each has the ability to collude with another employee on this day.	Separation of Duties - Each employee needs to rotate shifts and work with different employees every day of the week that he/she works.
Lucy has her own locked office. She could conceal fraudulent behavior more easily than the other employees. Her office is located in the back of the store away from other employees and customers.	Access Controls - Lucy should have video or other surveillance installed in her office. She should have windows that allow visible access into her office. Kayla should have a key to Lucy's office to monitor her actions.
Lucy prepares the bank deposits and records daily sales.	Separation of Duties - Kayla should examine and approve bank deposits and daily sales before they are completed in order to minimize fraud.
Advertising expenses could have been overstated and an employee could have pocketed the extra funds.	Documentation - Employees should be required to document every single transaction to the exact dollar amount that pertains to advertising and promotion. Kayla should check these transactions with the physical product.

Clerks are able to use coupons every time they purchase inventory from the store and can steal the difference from the register.	Authority Approval - Lucy or Kayla should be the only ones that can approve discounts and coupons with a unique code. If there is a large number of coupons, the coupons should be required to be scanned in before the sale and collected to show the customer the total that he/she owes.
As seen in the anonymous note left on her desk, Kayla leaves her office unlocked. Employees can steal money or inventory from her office.	Access Controls - Kayla should install office doors that automatically lock when they shut. This would prevent anonymous people from walking undetected into Kayla's office. Alternatively, Kayla should practice locking her door every time she leaves her office.
Employees are able to steal cash from the register during the day without Kayla knowing exactly which employee stole the cash.	Access Controls - Employees should be required to close out their cash box at the end of their shift at a particular register. This would show who is responsible if money goes missing. Employees should be required to only work on one register during his/ her shift, and each cash register should only be used by one employee each shift.

Additional Potential Fraud: If Kayla (the owner) is a potential suspect.
Kayla, acting as the owner of her store, also has the opportunity to steal from herself. Her ownership position would offer a good cover-up for committing fraud. She has her own office in the back of the store that only she has access to. She also has ultimate authority over the perpetual inventory records and inventory orders, she pays bills, handles payroll, takes deposits to the bank, and reconciles bank statements. She could easily steal from her business if she wanted to because she does not separate her powers, nor does she have anyone check all of the bank reconciliations that she deposits herself. Although Lucy prepares the bank deposits, Kayla could make new ones and deposit those without any approval or oversight from other employees. She also has overall control over the internal accounting system, so she could easily adjust the inventory, deposits, sales, returns, etc. in order for her to steal whatever she wants. As mentioned earlier, Kayla also has her own locked office in the back where she could hide the evidence of her theft and conspire to steal more.

CASE 6

WorldCom, Inc.

Prepared by: Kent Starling
November 16, 2016

"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

A.

A. Assets are things owned by an entity that have or can bring value.

B. Expenses are what an entity has to spend using or acquiring the assets.

C. If the amounts being paid out are going to creating a long-lasting asset, the costs should be capitalized.

B. After the costs are capitalized, they go on the balance sheet as part of the asset. They are then supposed to follow a planned amortization schedule in which they are gradually counted as an expense on the income statement.

C. Line costs were payment that WorldCom made to local telephone networks in order to complete calls.

Line Costs	14,739,000,000	
	Cash	14,739,000,000

D. The types of costs that were improperly capitalized at WorldCom were the line cost expenses. The transactions that resulted in the improper capitalization of the line costs were debiting property, plant, and equipment and crediting line costs in order to make line costs an asset.

E. These costs appeared on the balance sheet because they are improperly capitalized into the part of the asset in the PPE account. They appear in the operating section in the statement of cash flows.

F.

PPE	3,055,000,000	
	Line Costs	3,055,000,000

(in millions)	Depreciation		Remainder of Year	
First Quarter	$771	$22	100%	$35.05
Second Quarter	$610	$22	75%	$20.8
Third Quarter	$743	$22	50%	$16.89
Fourth Quarter	$931	$22	25%	$10.58
				$83.32

Depreciation Expense	83,306,000	
	Accumulated Dep	83,306,000

G.

Income before Taxes	$2,393,000,000
Add: Depreciation for year from F	$83,306,818

Deduct: Line Costs that were improper	($3,055,000,000)
Loss before Taxes	($578,693,182)
Income Tax Benefit	$202,542,613
Minority Interest	$35,000,000
Net Loss, Restated	($341,150,568)

Targa Co.

Prepared by: Kent Starling

January 25, 2017

“On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report.”

1. Targa should account for the one-time termination benefit of $2,500,000 would be an exit or disposal obligation(420-10-05-1).

The Exit or Disposal Cost Obligations Topic addresses financial accounting and reporting for costs associated with exit or disposal activities. An exit activity includes but is not limited to a restructuring. Those costs include, but are not limited to, the following:

a. Involuntary employee termination benefits pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract

b. Costs to terminate a contract that is not a capital lease

c. Other associated costs, including costs to consolidate or close facilities and relocate employees.

The cost of two weeks' severance to individual employees upon non voluntary termination of $500,000 would be a special termination benefits(712-10-25-1).

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.

The facility manager’s employment agreement of a lump-sum benefit of $50,000 upon closure of the facility would be a contractual termination benefit(712-10-25-2).

An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments.

2. Targa Company is required to record their retraining and relocating costs and expense them as they occur in accordance with 720-15-25-1 and 720-15-55-3.

Costs of start-up activities, including organization costs, shall be expensed as incurred.

A major U.S. beverage entity begins construction of a new plant in China. This represents the entity's initial entry into the Chinese market. As part of the overall strategy, the entity plans to introduce into China, on a locally produced basis, its major U.S. beverage brands. The following costs that might be incurred in conjunction with start-up activities are subject to the provisions of this Subtopic:

a. Travel costs, employee salary-related costs, and consulting costs related to feasibility studies, accounting, legal, tax, and governmental affairs

b. Training of local employees related to production, maintenance, computer systems, engineering, finance, and operations

c. Recruiting, organization, and training related to establishing a distribution network

d. Nonrecurring operating losses

e. Depreciation, if any, of new computer data terminals and other communication devices.

Merck Co, Inc

Prepared by: Kent Starling
February 8, 2017
"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

1. Common Stocks

1. Merck is authorized to use 5.4 billion shares of common stock.
2. Merck has 2.98 billion shares issued at December 31, 2007.
3. Merck has common stock with a value of $29.83 million.
4. There are 811 million shares of treasury stock.
5. The number of shares outstanding is 2.17 billion.
6. The market capitalization is $125.157 billion.

3. Investors are more likely to buy shares of stock in a company when the company pays dividends. Investors that are looking for high dividend yield stocks typically invest in the blue chip stocks which are all the companies that are very well-known essentially. The value of the stock typically decreases when the company pays a dividend because part of the value of the stock is tied to the dividend, so the stock price will always be highest in the days before the company announces a dividend if they do so on a very consistent basis.

4. Companies repurchase stock in order to raise their share price as well as keep control of their company. The stock also might be undervalued, so the company buys the stock to get cheaper capital in the future. If their stock price is consistently falling, they are able to raise the price of the stock by purchasing shares of it which would artificially raise the price of the shares.

5. Retained Earnings $3.31 billion

Dividends payable	$3.4 million
Cash	$3.3 billion

7. Treasury Stock

1. Merck is using the cost method in order to account for the treasury stock.

2. They purchased 26.5 million shares on the open market during 2007.

3. Merck paid $1.429 billion for 26.5 million which $53.95 per share. This is a financing cash flow.

4. Treasury stock is not an asset because it is a reduction of assets and stockholders equity. A corporation is unable to own part of itself.

(in millions)	2007	2006
Dividends Paid	$3,307.3	$3,322.6
Shares Outstanding	2,172	2,167.8
Net Income	$3,275.4	$4,433.8
Total Assets	$48,350	$44,569
Operating Cash Flow	$6,999.2	$6,765.2
Year-end Stock Price	$57.61	$41.94
Dividends per Share	$1.52	$1.53
Dividend Yield(dividends per share to stock price)	0.026	0.036
Dividend Payout (dividends to net income)	1.01	0.748
Dividends to Total Assets	0.0685	0.0745
Dividends to Operating Cash Flows	0.4730	0.4906

CASE 9

Xilinx, Inc

Prepared by: Kent Starling

February 22, 2017

“On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report.”

a. Stock option incentives provide employees with the opportunity after the plan is vested after a number of years to purchase stock in the future at a set price. It allows employees to gain more equity in the company. When employees have equity in the company in which they work they often have more pride in their work and stay longer.

b. Restricted stock units are different from stock option incentives because at the end of the vesting period, the employees are issued the predetermined number of shares of stock opposed to just the option to purchase the stocks. It is important to offer both types of compensation plans because different employees have different levels of acceptable risk. Employees with low risk tolerance are going to prefer RSUs because they are guaranteed to receive some sort of compensation if the price of the stock is below the option.

c. Grant date is the date of the issuance of either the options or RSUs. Exercise price is the purchase price set by the stock option. Vesting period is the amount of time an employee has to wait in order to exercise the stock options. The expiration date is when the stock options are no longer able to be redeemed. An option or RSU is granted when it is given to an employee for compensation. Options are exercised when an employee decides to redeem them. Options and RSUs are forfeited or canceled when an employee retires or quits before the options are fully vested.

d. Xilinx offers an employee stock purchase plan where qualified employees are able to obtain a two year purchase right to acquire Xilinx's common stock at the end of every

six month exercise period. Employees are able to purchase up to 15% of their annual earnings up of $21,000 worth of stock. The stock is offered at 85% the market value at the beginning of this option or the stock price at the end of each six month period, whichever is lower. This differs from RSUs and employee stock options because they are guaranteed to buy the stock at a price that they are instantly able to turn around and make a profit.

e. The company is required to record compensation expense for the amount of stock-based compensation that has not been vested. They account for it during this period by adopting a straight line method for the costs during the year. The compensation expense is debited while paid is capital options is credited because it is a contra equity account. Whenever an employee opts to exercise rights whenever it is after the vesting date then they account for that by debiting cash and paid in capital stock options and debiting common stock.

f.

   a. Xilinx reports $77,862,000 in stock-based compensation effect on income before taxes.

   b. Xilinx accounts for its employee stock options by debiting three expense accounts: cost of goods, research and development and sales, general and administration. They also credit additional paid in capital.

c. Xilinx has not had to spend cash to pay for the expense, so Xilinx adds the expense back into the statement of cash flow in the operating section.

d. Income tax effect of Xilinx's 2013 stock-based compensation expense is not deducted until the stocks are paid out so essentially the tax is paid right away. A deferred tax asset is created.

e.

Cost of Goods Sold	$6,356	
R&D Exp	$37,937	
SG&A	$33,569	
	APIC	$77,862
Deferred Tax Asset	$22,137	
	Income Tax Payable	$22,137

i.

a. Restricted stock units are becoming increasingly more popular because employees prefer them. They create less dilution of the stock, and they also create less risk because they will not be worthless unless the company collapse. Some corporate directors still support stock options because they have made fortunes off them.

b. The Wall Street Journal states that there has been a major shift from stock options to restricted stock units. In 1999, stock options were 78% of an executives long-term incentive package, now they are around 30%. Xilinx follows this trend very closely. They

have gone from granting 2,345 stock options in 2010 to 92 in 2012 where the number of RSUs granted have gone from 2,043 in 2010 to 3,018 in 2012.

CASE 10

Bier Haus, Inc

Prepared by: Kent Starling
March 6, 2017
"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

Part 1:

Step 1 (contract): When the student orders the beer and agrees to pay for it, this creates the contract between the student and Bier Haus.

Step 2 (identify separate performance obligations): The student expects to receive the beer and Bier Haus expects to receive the money from the student. The student expects to receive a mug of beer and Bier Haus expects to receive the $5.

Step 3 (determine transaction price): There is a predetermined amount of beer and money that is agreed upon during this step.

Step 4 (allocate the transactions): The transfer of goods happens during this step. The student gets the beer and the store gets the money.

Step 5 (recognize revenue): The student walks away with the cup of beer, and the store has the $5. Bier Haus records the sale.

Cash	$5		
	Alcohol Revenue	$5	

Part 2:

Step 1 (contract): The student orders the beer and the distinct mug.

Step 2 (identify separate performance obligations): The store understands that they are providing the mug and the beer for a discount than the separate standalone prices.

Step 3 (transaction price): The mug is $3 and the beer is $5 when separate but only $7 together.

Step 4 (standalone selling price): Bier Haus is going to allocate $4.3 dollars of the $7 to the beer and $2.7 to the mug.

Step 5 (recognize revenue): The student walks away with the mug of beer, and the store has the $7. Bier Haus records the sale.

Cash	$7		
	Alcohol Revenue	$4.3	
	Sales Revenue	$2.7	

Part 3:

Step 1 (contract): While the student orders a beer and a pretzel, Bier Haus is unable to fulfill that contract in the moment, so Bier Haus offers a counter-offer.

Step 2 (identify separate performance obligations): When Bier Haus offers the coupon for two pretzels for the price of one pretzel, Bier Haus understands that in the future they will have to fulfill this contract.

Step 3 (transaction price): The beer is $5 dollars and the coupon for 2 pretzels is worth $3.5 when separate but only $7 in this circumstance.

Step 4 (standalone selling price): The $7 dollars given to Bier Haus is split up with $4.12 going to the beer and $2.88 going to the pretzels.

Step 5 (recognize revenue): The student walks away with the mug of beer and the coupon for two pretzels, and the store has the $7. Bier Haus records the sale.

Cash	$7		
	Alcohol Revenue	$4.12	
	Unearned Food Revenue	$2.88	

Part 4:

Step 1 (contract): The student orders the two pretzels, and they offer the coupon as payment.

Step 2 (identify separate performance obligations): Bier Haus understands that the coupon was purchased in order to be redeemed at a later date.

Step 3 (transaction price): The pretzels are worth $2 each, but the student only paid $2 for the coupon.

Step 4 (standalone selling price): The alcohol and food revenue has already been recorded.

Step 5 (recognize revenue): The alcohol and food revenue has already been recorded.

Unearned Food Revenue	$2		
	Food Revenue	$2	

CASE 11

Zagg, Inc.

Prepared by: Kent Starling
March 23, 2017
"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

A. Book income is the amount of income that is stated on Zagg Inc's income statement. Zagg has a net income in their 2012 financial statements of $14,505,000. Tax and financial reporting of income can be different for a number of reasons. One of which is that is the difference in cash vs accrual basis recognition of income and expenses.

B. i. Permanent tax differences are transactions that will always be different between financial and tax reporting. Their differences will never be reconciled. Municipal bond interest is never taxable, so your financial income will be higher than your taxable income.

ii. Temporary tax difference are transactions that result in a difference between financial and tax reporting that are corrected in later years. An example would be depreciation. For tax purposes, depreciation is accelerated where for book purposes, it can be straight line.

iii. Statutory tax rate is the tax imposed by law.

iv. Effective tax rate is the actual amount of tax the tax payer contributes. It is calculated by dividing the amount of tax that is paid by their total taxable income.

C. A company reports their deferred income taxes as part of their total income tax expense instead of just their tax bill because their deferred income tax is part of what they pay during the year.

D. A deferred tax asset is a future tax that has already been paid. It is essentially a prepaid tax. An example of a deferred tax asset is prepaid rent. Another example would be refundable insurance premiums. A deferred tax liability is current tax that will be paid for in the future.

An example of this would be using accelerated depreciation for tax purposes while using straight line depreciation on Zagg's books

E. A deferred income tax valuation allowance is a tax asset that is not currently recognized because of deductible temporary differences and carry forwards. It should be recorded if a deferred tax asset has a more than 50% chance that it will not be realized.

F.

i.

Income Tax Expense	$9,393	
Net Deferred Asset	$8,293	
	Income Tax Payable	$17,686

ii.

Income Tax Exp	$9,393		
DTA	$8,002		
DTL	$291		
	Income Tax Payable	$17,686	

iii. ETR= Total Expense/ Pretax Income

$9393/ $23,898 =39.3%

iv. Deferred income tax assets of $6,912 is found in the current assets of the balance sheet. The non-current income tax assets is found in the non current section in the amount of

$6,912. They are broken up, so financial statement users will be able to distinguish between whether the deferred income tax assets will be recognized during the year or in a longer term.

CASE 5

Build-A-Bear, Inc.

Prepared by: Kent Starling

April 5, 2017

"On my honor, I pledge that I have neither given, received, nor witnessed an unauthorized help on this case report."

A. Companies chose to lease instead of buy for a number of reasons. The first of which is lower upfront costs. The company is able to pay for the product over time instead of all upfront. The company also usually get the most current equipment. There are also tax savings involved with business expensed payments.
B. An **operating lease** is a lease that is shorter than the useful life of the asset. A **capital lease** is where the lessor only finances the leased asset and all other rights of ownership transfer to the lessee at the end of the term. A **sales-type lease** is when the fair value of the leased property at the start of a lease varies from its carrying amount. It typically involves real estate, and there is a transfer of ownership to the lessee by the end of the lease term.
C. Operating leases are treated in a manner similar to rent payments. The payments are considered operating expenses and the equipment stays off the balance sheet. A capital lease is considered in the same way as a loan. The equipment stays on the balance sheet, and they received the title of the equipment at the end of the lease.
D.
   A. This is an operating lease because the title of the location does <u>not</u> transfer to Build-A-Bear at the end of the lease. These are in essence rent payments. The life of the lease is also significantly less than the useful life of the office.

B.

Lease Expense	$100,000		
	Cash	$100,000	

Year 1	Lease Expense	$100,000	
		Lease Payable	$100,000
Year 2	Lease Expense	$100,000	
	Lease Payable	$25,000	
		Cash	$125,000
Year 3	Lease Expense	$100,000	
	Lease Payable	$25,000	
		Cash	$125,000
Year 4	Lease Expense	$100,000	
	Lease Payable	$25,000	
		Cash	$125,000
Year 5	Lease Expense	$100,000	
	Lease Payable	$25,000	
		Cash	$125,000

C. E.

A. The amount of the rent expense on operating leases in fiscal year 2009 is the retail store base rent expense of $45.9 million and a contingent rents of $. 9 million which brings it to a total of $46.8 million.

B. The contingent rent and retail store base rent expense appear on the income statement under the selling, general, and administrative expense.

F.

N= 8		Discount Rate = 7%	
Year	Lease Payment	Discount Factor	Present Value of Payments
1	$50,651	0.9346	$47,337
2	$47,107	0.8734	$41,145
3	$42,345	0.8163	$34,566
4	$35,469	0.7629	$27,059
5	$31,319	0.7130	$22,330
6	$25,228.67	0.6663	$16,811
7	$25,228.67	0.6227	$15,711
8	$25,228.67	0.5820	$14,683
	Total Summation		$219,643

Leased Assets(P&E)	$219,643	
	Lease Obligation	$219,643

Lease Obligation	$35,276		
Interest Expense	$15,375		
	Cash	$50,651	
Depreciation Expense	$27,455		
	Acc Desperation	$27,455	

A. B. D.

G. Operating leases carry with it many advantages in terms of tax. The entire operating lease payment is deductible. Whereas, if it was a capital lease the en-

tire lease would go on the balance sheet, and it would be depreciated over the useable life of the property.

H.

A. The current assets would not change because the same cash is used each payment, and the long term asset is not included in the current ratio. The current ratio would decrease because the current liabilities would increase due to capitalizing the lease. The debt-to-equity ratio would increase because the lease obligation would be put on the books and raise Build-a-Bears' amount of debt. Build-a-Bear's long term debt to assets ratio would stay the same because the long term debt of the lease obligation would be added but the office would also be added to the assets. The decision to capitalize lease will not always yield weaker liquidity and solvency ratio. It depends on the net income, assets, and liabilities.

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