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A Synopsis of Basic Components of Accounting

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A SYNOPSIS OF BASIC COMPONENTS OF ACCOUNTING

by
Julius Jordan Boyd

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 2019

Approved by

Advisor: Dr. Victoria Dickinson

Reader: Dr. W. Mark Wilder

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This thesis is dedicated to my parents, Julius and Tammy Boyd. Their investment in my education has been the greatest gift I have ever received and I will cherish forever.

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Abstract

The purpose of this paper is to discuss different components of accounting and discuss how they appear on financial statements. These topics are ones that accountants run into everyday while on the job. Each case covers a company or companies and focuses on one of the major themes of the accounting process for that company. Along with this it also gives us a set of scenarios to discuss. These scenarios forced me to dive deeper into the financial statements to see how this is related to the United States generally accepted accounting principles. These cases go far beyond the everyday journal entries we see perceived most accountants doing.

CASE I: Glenwood Heating, Inc. and Eads Heaters, Inc.

In 20X1, Glenwood Heating, Inc. and Eads Heaters, Inc. began operations of selling home heaters. In the beginning, both companies had identical transactions to start their companies, but along the way began to differentiate themselves from one another with usage of different principles, both recognized under U.S. GAAP. With the comparing and contrasting of each company's Income Statement, Retained Earnings, and Balance Sheet I will present the first year's reports for the two companies.

The observation of similar companies in the same industry helps future investors analyze the specifics of a company and to make suggestions for each. With Eads, they took a conservative approach, but it hindered their first-year earnings, which are vital for a company in the first year. Glenwood took a riskier path which makes their first-year report look amazing, but also can be a major risk factor for some more conservative investors

Table 1.1 Eads Heaters Income Statement

Eads Heaters, Inc. Income Statement December 31, 20X1		
Revenue		
Sales	$398,500	
Cost of Goods Sold	(188,800)	
Gross Profit		209,700
Operating Expense		
Other Operating Expense	(34,200)	
Bad Debt Expense	(4,970)	
Depreciation Expense-building	(10,000)	
Depreciation Expense-equipment	(20,000)	
Depreciation Expense-leased equipment	(11,500)	
Total Operating Expense		(80,670)
Operating Income		129,030
Non-operating Expense		
Interest Expense	(35,010)	
Net Income Before Tax		94,020
Income Tax Expense	(23,505)	
Net Income		**70,515**

Table 1.2 Glenwood Heating Income Statement

Glenwood Heating, Inc. Income Statement December 31, 20X1		
Revenue		
Sale	$398,500	
Cost of Goods Sold	177,000	
Gross Profit		221,500
Operating Expense		
Other Operating Expense	(34,200)	
Bad Debt Expense	(994)	
Depreciation Expense-building	(10,000)	
Depreciation Expense-equipment	(9,000)	
Rent Expense	(16,000)	
Total Operating Expense		(70,194)
Operating Income		151,306
Non-operating Expense:		
Interest Expense	(27,650)	
Net Income Before Tax		123,656
Income Tax Expense	(30,914)	
Net Income		**$92,742**

Both companies had the same sales on record, but for Cost of Goods Sold Glenwood used the FIFO method while Eads used the LIFO method. This is one of the main causes of why their Income Statements are not the same. This, however, does not mean that overtime Glenwood will always have higher Net Income than Eads, but for the first year of business, the prices of the goods were lower at the beginning of the period and higher at the end of the period giving Glenwood and lower Cost of Goods Sold. Eads and Glenwood also used a different rate to calculate Bad Debt Expense. Eads went more conservative and measure 5% of ending Accounts Receivable compared to Glenwood's estimated 1%. Another difference is in allocated depreciation in the equipment; Glenwood used straight-line and Eads used double declining. With this being said, the depreciation for the equipment will equal out overtime, but for the first year it takes a really big toll on the Income Statement.

Table 1.3 Eads Heaters Statement of Retained Earnings

Eads Heaters, Inc. Statement of Retained Earnings Year Ended December 31, 20X1	
Beginning Retained Earnings	-
Plus: Net Income	$70,515
Less: Dividends	(23,200)
Ending Retained Earnings	**47,315**

Table 1.4 Glenwood Heating Statement of Retained Earnings

Glenwood Heating, Inc. Statement of Retained Earnings Year Ended December 31, 20X1	
Beginning Retained Earnings	-
Plus: Net Income	$92,742
Less: Dividends	(23,200)
Ending Retained Earnings	**69,542**

The retained earnings are still being affected the same way the Income Statement was being affected. We were told that both companies have the same Dividends Declared amount. Also the Earnings per Share rates are $28.98 for Glenwood and $22.04 for Eads. For an investor they would obviously want to invest in the company where they would earn more money. Overtime, these rates will seemingly become closer, but Glenwood's riskier move made them seem more investable after their first-year of operation.

Table 1.5 Eads Heaters Balance Sheet

Eads Heaters, Inc. Balance Sheet December 31, 20X1			
Assets			
Current Assets			
Cash		$7,835	
Accounts Receivable	99,400		
Less: Allowance for Doubtful Accounts	(4,970)	94,430	
Inventory		51,000	
Total Current Assets			153,265
Property, Plant, and Equipment			
Land		70,000	
Building	350,000		
Less: Accumulated Depreciation	(10,000)	340,000	
Equipment	80,000		
Less: Accumulated Depreciation	(20,000)	60,000	
Leased Equipment	92,000		
Less: Accumulated Depreciation	(11,500)	80,500	
Total Long-Term Assets			550,500
Total Assets			**703,765**
Liabilities & Owners' Equity			
Current Liabilities			
Accounts Payable		26,440	
Interest Payable		6,650	
Note Payable		380,000	
Total Current Liabilities		413,090	
Long-Term Liabilities			
Lease Payable		83,360	
Total Long-Term Liabilities		83,360	
Total Liabilities			496,450
Equity			
Common Stock		160,000	
Retained Earnings	70,515		
Less: Dividends Paid	(23,200)	47,315	
Total Equity			207,315
Total Liabilities and Equity			**703,765**

Table 1.6 Glenwood Heating Balance Sheet

Glenwood Heating, Inc. Balance Sheet December 31, 20X1			
Assets			
Current Assets			
Cash		$426	
Accounts Receivable	99,400		
Less: Accounts for Doubtful Accounts	(994)	98,406	
Inventory		62,800	
Total Current Assets			161,632
Property, Plant, and Equipment			
Land		$70,000	
Building	$350,000		
Less: Accumulated Depreciation	$(10,000)	$340,000	
Equipment	$80,000		
Less: Accumulated Depreciation	$(9,000)	$71,000	
Total Long-Term Assets			$481,000
Total Assets			**$642,632**
Liabilities & Owners' Equity			
Current Liabilities			
Accounts Payable		$26,440	
Interest Payable		$6,650	
Note Payable		$380,000	
Total Current Liabilities			$413,090
Equity			
Common Stock		$160,000	
Retained Earnings	$92,742		
Less: Dividends Paid	$(23,200)	$69,542	
Total Equity			$229,542
Total Liabilities and Equity			**$642,632**

In the Balance Sheet we discovered more of the inner workings of the company. As it is concerning that Glenwood only has $426 in cash on hand, I still feel that this would be the better company to invest in. Eads is greatly affected by the Leased

Equipment they have at the moment and even though it does raise their overall Assets, it also brings up their Liabilities.

APPENDIX 1: Supportive Graphs and Charts for Tables 1.1-1.6

1.a Home Heaters Records of Transactions

Home Heaters						
Recording basic transactions						
Transactions	Cash	Accounts Receivable	Inventory	Land	Building	Equipment
No. 1	$160,000					
No. 2	$400,000					
No. 3	$(420,000)			$70,000	$350,000	
No. 4	$(80,000)					$(80,000)
No. 5			$239,800			
No. 6		$398,500				
No. 7	$299,100	$(299,100)				
No. 8	$(213,360)					
No. 9	$(41,000)					
No. 10	$(34,200)					
No. 11	$(23,200)					
No. 12						
Balances	**$47,340**	**$99,400**	**$239,800**	**$70,000**	**$350,000**	**$80,000**
=						
Transactions	Accounts Payable	Note Payable	Interest Payable	+	Common Stock	Retained Earnings
No. 1					$160,000	
No. 2		$400,000				
No. 3						
No. 4						
No. 5	$239,800					
No. 6						$398,500
No. 7						
No. 8	$(213,360)					
No. 9		$(20,000)				$(21,000)
No. 10						$(34,200)
No. 11						$(23,200)
No. 12			$6,650			$(6,650)
Balances	**$26,440**	**$380,000**	**$6,650**		**$160,000**	**$313,450**

1.b Home Heaters Unadjusted Trial Balance

Home Heaters Unadjusted Trial Balance	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		6,650
Common Stock		160,000
Dividend	23,200	
Sale		398,500
Other Operating Expense	34,200	
Interest Expense	27,650	
Total	**971,590**	**971,590**

CASE II: Molson Coors Brewing Company

In the case, we look at the Molson Coors Brewing Company and assessed many attributes of their income statement. We started by defining different parts of the income statement before we assessed the given statements from Molson Coors. Molson Coors is the seventh largest brewing company and is worth around $5 billion. Since being worth so much, their income statement was quite intricate.

I focused on the cash flow of the company and the return of net operating assets. This is basically the income the company generates. In the business world, this is highly important and a huge factor investors look at when they are deciding in what company to invest in. If a company has a high return of net operating assets that usually means the company is working well and a safe one to invest in. In this study, I addressed where Molson Coors Brewing Company was performing well and also the differences that were in their statements.

A. Major Classifications of Income Statement include:

1. Operating Section: First part of the Income Statement that reports the revenues and expenses of the company's major operations.

    (a) Sales or Revenue: This subsection presents sales, discounts, allowances, returns, and other related information. Its main purpose is to get to net amount of sales revenue.

    (b) Cost of Goods Sold: This subsection shows the cost of goods that were sold to produce the sales. Once Cost of Goods Sold is found, you subtract it from net sales to get Gross Profit.

    (c) Selling Expense: This subsection details the expenses that arise from the company's attempt to create sales.

    (d) Administrative or General Expenses: The subsection list expenses the company's general administration.

2. Non-operating Section: Second part of the Income Statement that reports the revenues and expenses resulting from secondary activities of the company. In addition, special gains and losses that are infrequent or unusual are normally reported in this section. Generally these items break down into two main subsections.

(a) Other Revenues and Gains: A list of the revenues recognized and gains incurred during the period, generally net of related expenses, from non-operating transactions.

(b) Other Expenses and Losses: A list of the expenses or losses incurred, generally net of any related incomes, from non-operating transactions.

3. Income Tax: Third part of the Income Statement that reports federal and state taxes imposed on the company's income from continuing operations.

4. Discontinued Operations: Fourth part of the Income Statement that lists material gains or losses from the disposal of a component of the business.

5. Noncontrolling Interest: Fifth part of the Income Statement that allocates income to noncontrolling shareholders.

6. Earnings per Share: Sixth and final part of the Income Statement that measures the performance of the company during the reporting period.

B. Reason why under U.S. GAAP companies are supposed to provide "classified" income statement.

US companies are required to provide classified income statements in accordance with U.S. GAAP to provide transparency in the interworking of the accounting process of a given company. The classified balance sheet first and foremost breaks down a company's assets into long-term and current assets. This shows the liquidity of the company or its ability to satisfy short-term debts. The classified income statements also break down a company's operations even more and can be compared to other company's to see how they match up in operations and other crucial points. In short, it has the income a company has made over a period of time rather than over the life of the company. It also has it listed in a way investors and directors can understand and clearly see how the company is doing operating wise.

C. Why financial statement users be interested in persistent income?

A financial statement user would be interested in a company's persistent income because they would have a vested interest in whether a company's earnings are sustainable from year to year. It is more dependable for the future because it factors in random events that could have spiked income or lowered it.

D. Definition of Comprehensive Income and difference from net income

Comprehensive Income is a statement of all income and expenses recognized during a specific period. It provides an overview of sales and expenses, including taxes and interest. Comprehensive Income includes all the gains and losses of a company that make up their net income, but it also includes all the gains and losses in the stockholder's equity as well.

E. The income statement reports "Sales" and "Net sales." What is the difference? Why does Molson Coors report these two items separately?

Molson Coors reports Sales and Net Sales on their income statement because of the excise tax. An excise tax is a tax on a good collected for the selling or shipping of the good. Molson Coors has put in their notes that this excise tax was from the shipping of the beer. This tax goes straight to the government from the purchasing of the product so Molson Coors chose to take out this tax at sales so they wouldn't overstate Net Sales.

F. Consider the income statement item "Special items, net" and information in Notes 1 and 8.

i. In general, what types of items does Molson Coors include in this line item?

Molson Coors lists employee-related charges, impairments, unusual items, termination fees and other gains and losses under Special Items. These types of items are most commonly impairments of intangible assets specifically in the abroad offices in Europe and Canada.

ii. Explain why the company reports these on a separate line item rather than including them with another expense item. Molson Coors classifies these special items as operating expenses. Do you concur with this classification? Explain.

Special items are listed on a different line item than other expenses so the company can differentiate these expenses from the others and also show how irregular they are too. These are separated to provide the user the proper information for comparability of financial statements within the company's year-to-year reports.

G. Consider the income statement item "Other income (expense), net" and the information in Note 6. What is the distinction between "Other income (expense), net" which is classified a non-operating expense, and "Special items, net" which Molson Coors classifies as operating expenses?

Other Income Expenses are gains and losses that are associated with activities not directly related to the everyday operations of the company. These include facility fees, currency conversion gains and losses, and gain on sale of non-operating assets. The difference between Other Income Expense and Special Items is that Income Expenses are very frequent and usually happen every period while Special Items are infrequent and rarely happen. When they do happen they still must be documented, but they are documented in their own line to show a user that these gains and losses are necessarily normal for the organization.

H. Refer to the statement of comprehensive income.

   i. What is the amount of comprehensive income in 2013? How does this amount compare to net income in 2013?

Comprehensive Income in 2013 is $765.4 million while net income is $572.5 million. Net income is lower because it does not factor in the non-operating gains. In the case of

Molson Coors, they are not realizing foreign currency adjustment, pension adjustments, and unrealized gains. The Comprehensive Income focuses on the change in owner's equity by definition and Net Income focuses on the revenue and expenses of the company. Net Income is actually a part of Comprehensive Income, but Comprehensive Income also factors in other events and transactions throughout the period that effects owner's equity too.

ii. What accounts for the difference between net income and comprehensive income in 2013? In your own words, how are the items included in Molson Coors' comprehensive income related?

There is a $188.7 million difference in the two accounts. This difference comes from accounts that are factored into the Comprehensive Income and not Net Income. These accounts are foreign currency adjustments, pension adjustments, and unrealized gains. These accounts are classified as non-operating gains and they are not in Net Income because Net Income only focuses on the operating income of the business.

J. What is Molson Coors' effective tax rate in 2013?

Molson Coors' effective tax rate is 12.8 percent in 2013. This is calculated by dividing the income tax expense (84 million) by total pretax income (654.5 million). Both of these numbers are found in Note 7 on the report.

CASE III: Pearson plc

This case study focuses on the receivables Pearson plc has. Pearson plc is a British company that educational publishing. This company published many academic books. Pearson plc, being in the sales industry, has a great amount of accounts receivable so they are a prime company to hone in on.

With the accounts receivable, I first defined the term and also the close relative to this accounts, notes receivable. After this I discussed the differences between the two. Once the difference was stated, I think took pieces of Pearson plc’s financials and analyzed from the standpoint of receivables. After that I have followed the directions of the case and have broken down the analysis of the different of accounts receivables and explained the differences.

In this case, I learned how big of an umbrella account receivable really is. There is many business components that flow in and out of this account and it is shown through this case. I also tried to promote the importance of proper ledger labeling for this account. In my research of accounts receivable, I found how many companies struggle with the proper labeling of the actions that are happening to this account.

a. What is an account receivable? What other names does this asset go by?

Account Receivable is a current asset account that total represents the sales incurred by a company made on credit but expect a cash equivalent of this amount in the recent future. This account is paired with Sales Revenue. Another name for this account would be Trade Receivables which presents an amount to be collected in the near future for a product or service.

b. How do accounts receivable differ from notes receivable?

Notes Receivable refer to the amount to be collected from crediting or allowing a customer to borrow whereas Accounts Receivable refers to the amount to be collected from a sell of an item on credit. Accounts Receivable is more sell oriented while Notes Receivable is more lending oriented. Notes Receivable can also be a long-term asset while Accounts Receivable is always a current asset. This hinges on the agreement between the borrower and the lender of the note and how and when they will pay the note back. Notes receivable are often interest bearing whereas accounts receivable are not.

c. What is a contra account? What two contra accounts are associated with Pearson's trade receivables (see Note 22)? What types of activities are captured in each of these contra accounts? Describe factors that managers might consider when deciding how to estimate the balance in each of these contra accounts.

A contra account is an account that's normal balance is opposite of the account it is associated with. This will lower the net of the main account, while showing where the reduction is. Pearson's two contra accounts are Allowance for Doubtful Accounts and Allowance for Sales Returns and Allowances. Allowance for Doubtful Accounts is a contra-asset account for Accounts Receivable and it is to show the estimated amount that the company will not collect from their receivables. Allowance for Sale Returns and Allowances is a contra-revenue account for Sales Returns and Allowances for returns on sales for whatever reason. Managers may consider a multitude of factors when establishing these accounts. They are both an estimate, but he/she may look at prior periods and see how many receivables were not collected or how many returns were made and also the general economy environment. They also have to consider that whatever amount they establish will lower their net income since it will be lowering net Accounts Receivable and Sales Revenue.

d. Two commonly used approaches for estimating uncollectible accounts receivable are the percentage- of-sales procedure and the aging-of-accounts procedure. Briefly describe these two approaches. What information do managers need to determine the activity and final account balance under each approach? Which of the two approaches do you think results in a more accurate estimate of net accounts receivable?

Percentage-of-sales procedure is estimating the amount that won't be collected based on historical accounts that have remained uncollectable. A manager would look back on prior periods to see the percent of accounts receivable were unpaid. They would then use the same percent or a different if they seem deemed based on the current state of the economy. With the aging-of-accounts method they see how far an account is left unpaid and use a percent per age of these accounts. The manager would need prior period records for both; for percentage-of-sales they would need to see the amount left unpaid while the aging-of-accounts they would the date in which each accounts receivable was recorded first. I believe aging-of-accounts is more accurate since it is giving each age category a different percent rather than a broad percentage for all outstanding accounts receivables. Aging-of-accounts is also accounts specific which makes it easier to assess each account while percentage-of-sales is not accounts specific but just a broad number that correlates with prior period research.

e. If Pearson anticipates that some accounts will be uncollectible, why did the company extend credit to those customers in the first place? Discuss the risks that managers must consider with respect to accounts receivable.

While Pearson does not want to have uncollectible accounts, it is almost impossible to not have. Pearson still extends credit to these customers is sometimes they simply do not know that they won't pay their accounts payable to them. If it a customer that has had uncollectible accounts in the past they may not extend the credit offer, but if they do they may do it with higher consequences. Also they may extend credit because it shows that Pearson is flexible and can take the risks on some accounts going uncollectible. This flexible is likes by potential investors.

f. Note 22 reports the balance in Pearson's provision for bad and doubtful debts (for trade receivables) and reports the account activity ("movements") during the year ended December 31, 2009. Note that Pearson refers to the trade receivables contra account as a “provision.” Under U.S. GAAP, the receivables contra account is typically referred to as an “allowance” while the term provision is used to describe the current-period income statement charge for uncollectible accounts (also known as bad debt expense).

i. Use the information in Note 22 to complete a T-account that shows the activity in the provision for bad and doubtful debts account during the year. Explain, in your own words, the line items that reconcile the change in account during 2009.

Provision for Bad and Doubtful Debts (in millions)

	72
5	
	26
20	
	3
	76

The credit of 72 is the beginning balance of the account during the year 2009. It is also the ending balance of the account in 2008, which will roll over into 2009. The Debit of 5 is for the currency exchange difference. Pearson, plc is a company based in the United Kingdom where the currency is the Pound (£). This entry is accounting for the Bad Debt that happened with transactions abroad and this is showing the exchange rate difference from the country’s currency to the English Pound. Pearson actually had £5 million less when they calculated the foreign Bad Debt into Pounds. The 26 Credit is the Bad Debt Expense that affects the Income Statement. This is transaction is for the accounts that have not been paid for but the Pearson is budgeting that 26 million of them won't be paid for. The Debit of 20 is to account for the Bad Debt that we do not think we will ever collect. We must clear this amount off of all our books because that amount will never be collected. The Credit of 3 is from the Bad Debt Pearson took on from acquisitions of other companies that they have a share in.

ii. Prepare the journal entries that Pearson recorded during 2009 to capture 1) bad and doubtful debts expense for 2009 (that is, the "income statement movements") and 2) the write-off of accounts receivable (that is, the amount "utilised") during 2009. For each account in your journal entries, note whether the account is a balance sheet or income statement account.

1.)	Bad Debt Expense	£26,000,000	
	Provision for Bad and Doubtful Debts		26,000,000

-Bad Debt Expense is an income statement account

-Provision for Bad and Doubtful Debts is a balance sheet account

2.)	Provision for Bad and Doubtful Debts	£20,000,000	
	Accounts Receivable		20,000,000

-Provision for Bad and Doubtful Debts is a balance sheet account

-Accounts Receivable is a balance sheet account

iii. Where in the income statement is the provision for bad and doubtful debts expense included?

Bad and Doubtful Debts Expense is included in the operating expense on the Income Statement

g. Note 22 reports that the balance in Pearson's provision for sales returns was £372 at December 31, 2008 and £354 at December 31, 2009. Under U.S. GAAP, this contra account is typically referred to as an "allowance" and reflects the company's anticipated sales returns.

i. Complete a T-account that shows the activity in the provision for sales returns account during the year. Assume that Pearson estimated that returns relating to 2009 Sales to be £425 million. In reconciling the change in the account, two types of journal entries are required, one to record the estimated sales returns for the period and one to record the amount of actual book returns.

Provision for Sales Returns

	372
	425
443	
	354

ii. Prepare the journal entries that Pearson recorded during 2009 to capture, 1) the 2009 estimated sales returns and 2) the amount of actual book returns during 2009. In your answer, note whether each account in the journal entries is a balance sheet or income statement account.

1.) Sales Returns and Allowances	£425,000,000	
Provision for Sales Returns		425,000,000

-Sales Returns and Allowances is an Income Statement accounts

-Provisions for Sales Returns is a Balance Sheet account

2.) Provisions of Sale Returns	£443,000,000	
Trade Receivables		443,000,000

-Provision of Sales Returns is a Balance Sheet account

-Trade Receivables is a Balance Sheet account

iii. In which income statement line item does the amount of 2009 estimated sales returns appear?

Estimated sales returns shows up in the Sales line of the Income Statement.

h. Create a T-account for total or *gross* trade receivables (that is, trade receivables before deducting the provision for bad and doubtful debts and the provision for sales returns). Analyze the change in this T-account between December 31, 2008 and 2009. (*Hint*: your solution to parts *f* and *g* will be useful here). Assume that all sales in 2009 were on account. That is, they are all “credit sales.” You may also assume that there were no changes to the account due to business combinations or foreign exchange rate changes. Prepare the journal entries to record the sales on account and accounts receivable collection activity in this account during the year.

Gross Trade Receivable

1474	
	20
5624	
	443
	5216
1419	

The beginning balance is £1,474,000,000, which in the ending balance of this account in 2008. The deduction of 20 on the second line is from the account where we are assuming we will not collect any of debt of this amount (also seen in F(i)). The 5,624 is all the credit sales recorded during the period. We also have a crest to Sales Revenue for this as well. The 443 deduction is for all the sales returns during 2009. This amount is also credited to trade receivables to remove that receivable amount. The 5216 deduction is from receipts of credit sales payment during the period. This will also include a debit entry to the cash account.

CASE IV: Aero Company

In the case we were to look at the financials for Aero Company. This problem came from our Intermediate Accounting Textbook. In this problem, we were given information about the company and we were supposed to create the Statement of Cash Flow and Balance Sheet from the information. This was a very real world problem for most accountants. Creating and knowing what to look for in the financial information is very tricky sometimes when creating these statements. At the beginning I have posted the limited information we were given and then to follow are the two statements I created along with an explanation and key for calculations.

The Introductory information for Aero Inc. is given as follow on December 31st, 2016:

AERO INC. Balance Sheet December 31st, 2016			
Cash	$20,000	Accounts Payable	$30,000
Accounts Receivable	21,200	Bonds Payable	41,000
Investments	32,000	Common Stock	100,000
Plant assets (net)	81,000	Retained Earnings	23,200
Land	40,000		
	$194,200		$194,200

The left and the right side should always be equal since Assets equal Liabilities plus Equity (A=L+E).

The next part, we are told that these 7 actions occurred during the year of 2017.

1. Aero liquidated its available-for-sale debt investment portfolio at a loss of $5,000
2. A tract of land was purchased for $38,000
3. An additional $30,000 in common stock was issued at par
4. Dividends totaling $10,000 were declared and paid to stockholders
5. Net income for 2017 was $35,000, including $12,000 in depreciation expense
6. Land was purchased through the issuance of $30,000 in additional bond
7. At December 31, 2017, Case was $70,200, Accounts Receivable was $42,000, and Accounts Payable was $40,000

a. The statement of cash flow would look as followed

AERO INC.
Statement of Cash Flows
For the Year Ended December 31, 2014

Cash flows from operating activities		
Net income		$35,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$12,000	
Loss on sale of investments	5,000	
Increase in accounts payable ($40,000 – $30,000)	10,000	
Increase in accounts receivable ($42,000 – $21,200)	(20,800)	6,200
Net cash provided by operating activities		41,200
Cash flows from investing activities		
Sale of investments	27,000	
Purchase of land	(38,000)	
Net cash used by investing activities		(11,000)
Cash flows from financing activities		
Issuance of common stock	30,000	
Payment of cash dividends	(10,000)	
Net cash provided by financing activities		20,000
Net increase in cash		50,200
Cash at beginning of year		20,000
Cash at end of year		$70,200

Noncash investing and financing activities

Land purchased through issuance of $30,000 of bonds

To put together the table above, you must consider all the information the problem gives you. A cash flow is split in 3 different categories: operating, investing, and financing as seen above. In the operating section, you begin with Net Income and in #5 it was stated to be $35,000. After that you take into consideration depreciation expense and gains and losses. Also in #5, it was disclosed that there was $12,000 of depreciation expense that you would add back to the operating activities. I, however, have it set up to where all things that will change Net Income are thrown into a lump sum and then added at the end. You may choose to do this however you want, but I find it easier to list them all out, record them in their own row, and then either add or subtract to the Net Income. Loss of sale of investment will also be added back and that total was $5,000 as stated in #1. Then you will look at Accounts Payable and Accounts Receivable. We find that in Accounts Payable there is an increase of $10,000 from using the 2016 End of the Year number and the 2017 End of the Year number in #7. When Accounts Payable Increases, we add it back to Net Income. In Accounts Receivable, there is a increase of $20,800 by using the End of Year numbers for 2016 and 2017 found in the introduction. When Accounts Receivable increases, we subtract it from the total. When adding depreciation expense, loss on sale of equipment, change in accounts payable, and subtracting the change in accounts receivable, we get a total of $6,200 to add to Net Income giving us $41,200 in cash from operating activities.

Next up we have investing activities. In #1, we see they sold their investments for a lost of $5,000, which means they sold them at $27,000. We would then consider the purchase of land that was stated in #2 of $38,000 that would decrease the cash flow. This would ultimately give us a total of $11,000 to subtract from cash flow.

The final part of the statement of cash flows is financing activities. This is just the issuance of common stock during the period ($30,000 given to us in #3) minus dividends paid ($10,000 giving in #4). We have a net total of $20,000 in financing activity that we will combine with the other totals.

So now we have the 3 sums for each section; $41,200, (11,000), and 20,000. By combining them we get a total of $50,200 for the net increase of cash during the period. To find cash flow for year-end we would then take the $50,200 and the cash on hold at the beginning of the period of $20,000 and get a total of $70,200.

b. The unclassified balance sheet would look as followed

AERO INC.
Balance Sheet
December 31, 2014

Assets			Liabilities and Stockholders' Equity		
Cash	$ 70,200		Accounts payable	$ 40,000	
Accounts receivable	42,000		Bonds payable	71,000	(3)
Plant assets (net)	69,000	(1)	Common stock	130,000	(4)
Land	108,000	(2)	Retained Earnings	48,200	(5)
	$289,200			$289,200	

Calculations for Balance Sheet:

(1) \$81,000 – \$12,000

Original Plant assets – depreciation expense

(2) \$40,000 + \$38,000 + \$30,000

Original land value + land purchased + land purchased with issuance of stock

(3) \$41,000 + \$30,000

Original bonds payable + issuance of bond for land

(4) \$100,000 + \$30,000

Common Stock total + common stock issued

(5) \$23,200 + \$35,000 – \$10,000

Beginning Retained Earnings + Net Income in 2017 – Dividends

CASE V: Palfinger AG

Palfinger AG is an Austrian company that specializes in hydraulic lifting and other crane systems for construction. Because of the size of Palfinger, they have a fair amount of property, plant, and equipment (PPE). In this case we focused on the PPE of Palfinger and their financials

PPE is much of a company's asset. Without PPE companies could not produce, build, or sale anything. This is basically the bones of an organization. Because PPE is so valuable, there are many regulations and rules to it when it comes to the accounting standpoint. In this case, we studied how PPE for Palfinger affects the statements. PPE is either wholly owned or leased. Even with some of the wholly owned PPE, there are more rules that come with it because most companies will borrow money to purchase it.

Another factor we looked at was the depreciation that correlates to the PPE. We looked at how double-declining method and straight-line method. This is another important part of PPE because every year each PPE is depreciated based on the type of asset it is.

In this case, I found out how intricate the accounting purpose for PPE is. It is not just simply recording the cost of what you paid for it and how much money you spent on it. This is one of the most heavily documented part of a business because of the depreciation aspect of PPE and also if there are loans attached to the asset. In this case I outlined and explained many scenarios related to the property, plant, and equipment of Palfinger and how it is reflected in the financial statements of the company.

a. Based on the description of Palfinger above, what sort of property and equipment you think the company has?

Based on the brief description, Palfinger would need a lot of steel, rubber, welding equipment, and technology specific for crane building for the sort of property and equipment they are producing. They would also have equipment that has the capability to piece together the parts of the crane and that could screw or weld them into place.

b. The 2007 balance sheet shows property, plant, and equipment of €149,990. What does this number represent?

Property, plant, equipment on the 2007 balance sheet includes land and buildings, undeveloped, plant and machinery, fixtures, fittings, and equipment, prepayments and assets under construction. Also it also is the net amount because some of these categories have depreciated and they have taken account for that.

c. What type of equipment does Palfinger report in notes to the financial statements?

The equipment Palfinger reports are machinery inside plant, fixtures, fittings, and other equipment that will help with constructing their products they are not disclosed in the case. Anything Palfinger uses on a daily for production is reported under equipment.

d. In the notes, Palfinger reports "Prepayments and assets under construction." What does this subaccount represent? Why does this account have no accumulated depreciation? Explain the reclassification of €14,958 in this account during 2007.

In this category, Palfinger is putting items that are under construction in it. This account basically could be called construction in progress. These are prepaid property, plant, and equipment. It is not being depreciated because it is not in use so there is no wear and tear of these items from Palfinger. Depreciation only affects the useful life of the property, plant, and equipment and in this category they are not in effect so they have not start operating or being useful to the production of products or for the Palfinger yet. The €14,958 represents property, plant, and equipment being removed from the prepayment column into the columns that Palfinger uses for everyday use. Palfinger reclassifies these because they begin their useful life for the company and they now start depreciating these items.

e. How does Palfinger depreciate its property and equipment? Does this policy seem reasonable? Explain the trade-offs management makes in choosing a depreciation policy.

Palfinger depreciates its PPE using straight-line depreciation method. Straight-line is very simple to compute so it would be easier for the accounting department of Palfinger. The assets could be depreciated at net scrap value or zero value, which means it, can take the asset to its full depreciable cost. This policy does seem reasonable because it is declining the same amount each year and it if it is doing the same job and same activity during those years then it should be fine to depreciate it evenly. However, if Palfinger wanted they could use double-declining depreciation. This is a much more tedious calculation, but some critics argue it is more reasonable to use since it takes a certain percentage each year rather than a standard one. Some say this is better because the company has to reevaluate the asset each year. I believe both are reasonable and do not think Palfinger needs to change unless they seem fit to.

f. Palfinger routinely opts to perform major renovations and value-enhancing modifications to equipment and buildings rather than buy new assets. How does Palfinger treat these expenditures? What is the alternative accounting treatment?

Palfinger treats renovation as an expense, but can add value to this asset to increase its useful life. A value-enhancing modification is treated as an investment for Palfinger. This alters the useful life of the expected life of the PPE because they are improved from their previous state. This will also change the depreciation process since it has a new expected life. Another way Palfinger could treat is creating a new equity account rather than expensing it. Palfinger could debit the asset for the improvement and then credit a reserve account that would fall under equity. This would keep the basic accounting equation balanced. Creating new equity could affect Palfinger's retained earnings.

g. Use the information in the financial statement notes to analyze the activity in the "Property, plant, and equipment" and "Accumulated depreciation and impairment" accounts for 2007. Determine the following amounts;

   i. The purchase of new property, plant, and equipment in fiscal 2007.

The purchases of property, plant, and equipment is €61,444. You can locate this number in the notes for the financial statements under change of PPE.

ii. Government grants for purchase of new property, plan, and equipment in 2007. Explain what these grants are and why they are deducted from the property, plant, and equipment.

Palfinger uses government grants (cash or loans from government) to purchase new PPE. Palfinger chooses to deduct these from its carrying amount from the PPE they buy with it. Palfinger records the asset at fair value because it does increase assets. The deduction is in the PPE category. This is because the government grants are in used to acquire or purchase these assets that fall under PPE. Palfinger cannot record the asset with no value because there is value that comes with the assets. The glitch is that the company itself is not using its own funds to purchase the equipment. Palfinger deducts the grant from the carrying value of the asset per IAS rules on deduction of assets obtain via government grants.

iii. Depreciation expense for fiscal 2007.

2007 Depreciation expense for Palfinger is €12,557. This is found in the notes of the financial statements under "accumulated depreciation and impairment".

iv. The net book value of property, plant, and equipment that Palfinger disposed of in the fiscal 2007.

The net book value of the disposal of PPE in 2007 for Palfinger is €1,501. This is found by looking in the notes and taking acquisition cost of disposals and subtracting the accumulated depreciation of disposal from it. The equation is €13,799- €12,298 = €1,501.

h. The statement of cash flows (not presented) reports that Palfinger received proceeds on the sale of property, plant, and equipment amounting to €1,655 in the fiscal 2007. Calculate the gain and loss that Palfinger incurred on this transaction. Hint: use the net book value you calculated in part g iv, above. Explain what this gain or loss represents in economic terms.

Palfinger saw a gain from disposing PPE, but only of €154 ($178.60). This represents the revenue Palfinger recorded for this transaction. You would calculate this by using the sale amount in the question (€1,655) and subtracting the total you got from g iv (€1,501). We calculated that number by subtracting the accumulated depreciation from the acquisition cost of the PPE. The Journal would look like:

Cash	€ 1,655	
Accumulated Depreciation	12,298	
Property, Plant, and Equipment		13,799
Gain on sale		154

The gain represents the profit Palfinger made on the selling of this PPE. The book value of the PPE was less than what they sold it for. This is a positive effect on the financial statements. It is not a large gain, but still will have an effect since the amount that PPE was worth was less than the selling cost or cost of disposal.

i. Consider the €10,673 added to "Other plant, fixtures, fittings, and equipment" during the fiscal 2007. Assume that these net assets have an expected useful life of five years and a salvage value of €1,273. Prepare a table showing the depreciation expense and net book value of this equipment over its expected life assuming that Palfinger recorded full year of depreciation in 2007 and the company uses:

i. Straight-Line Depreciation

ii. Double-Declining-Balance Depreciation

Year	Straight-Line	Double-Declining
1	€10,673- €1,273= **€1,880**	1/5=.2 .2(2)=.4 *10,673*(.4)= **€4,269**
2	**€1,880**	10,673-4269=*6,404* 6,404(.4)= **€2,562**
3	**€1,880**	6,404-2562=*3,842* 3,842(.4)= **€1,537**
4	**€1,880**	3,842-1,537=*2,305* 2,305(.4)= **€922**
5	**€1,880**	2,305-922=*1,383* 1,383-1,273= **€110**

If Palfinger would have different book values of the equipment depending on which method they used. With Straight-Line the net value is €8,793 and under Double-Declining it is €6,404. The depreciation expense for the PPE whole useful will be the same after 5 years under both methods. It is just the €10,673 - €1,273 or €9,400.

j. Assume that the equipment from part *i*. was sold on the first day of fiscal 2008 for proceeds of €7,500. Assume that Palfinger's accounting policy is to take no depreciation in the year of sale.

i. Calculate any gain or loss on this transaction assuming that the company used straight-line depreciation. What is the total income statement impact of the equipment for the two years that Palfinger owned it? Consider the gain or loss on disposal as well as the total depreciation recorded on the equipment (i.e. the amount from part $i.\ i.$).

Cash	€7,500	
Accumulated Depreciation	1,880	
Loss on Sale	1,293	
Equipment		10,763

Palfinger would incur a loss of 1,293 if they were using the Straight-Line Method. There is a loss because they sold the PPE for less than the net value of it. This would lower their Retained Earnings by the amount of the loss. The first year Palfinger would only have a depreciation expense on the books, but the second year they would have to record the loss. Palfinger would not record depreciation expense the second year.

ii. Calculate any gain or loss on this transaction assuming the company used double-declining- balance depreciation. What is the total income statement impact of this equipment for the two years that Palfinger owned them? Consider the gain or loss on disposal as well as the total depreciation recorded on the equipment (i.e. the amount from part $i.\ ii.$).

Cash	€7,500	
Accumulated Depreciation	4,269	
Gain on Sale		1,096
Equipment		10,763

Palfinger would incur a gain of 1,096 if they were using the Double-Declining Method. This is because the net value of the PPE would be less than the amount it was sold for. This is not unusually since with Double-Declining, the depreciation expense is higher at the beginning on the PPE’s useful life and since this PPE has only been in action for 1 year. In the second year they would only record the gain from the sale and you wouldn't depreciate the PPE in the second year.

iii. Compare the total two-year income statement impact of the equipment under the two depreciation policies. Comment on the difference.

The total income statement impact for both methods is actually the same. In the Straight-Line method, the depreciation expense is lower, but there is a lost and in the Double-Declining the depreciation expense is higher, but there is a gain to counter that. Both would have a net income statement impact of 3,173. The only effect is that the gain looks somewhat better on the statement because it goes into the Retained Earnings. That can lead people to believe that Double-Declining is better, but once you take into the effect of the Depreciation Expense this seem to be good things turns out to not be that beneficial. This shows that each Depreciation Expense method doesn't matter if you are selling the PPE. If Palfinger was going to hold on to the PPE rather than selling, the Depreciation Expense would be standard for Straight-Line and large and the beginning and small at the end for Double-Declining. Regardless, the total accumulated depreciation would be the same at the end of the PPE's useful life.

CASE VI: Volvo Group

The Volvo Group is a Swedish company that produces commercial vehicles and automobiles. The case focuses on the intangible assets of the financial statements from the company, mainly focus in the software and development part of the assets. The issue that came up was the Research & Development rules under U.S. GAAP and IFRS have different rules are we were to compare and contrast the two with companies: Volvo from Sweden and Navistar in the United States. Under U.S. GAAP, all research and developments costs must be expense while the International rule is that any cost for development that helps the company financially in the future may be capitalized.

The beginning of the case was for us to familiarize with the International Research & Development to understand the financial statements of Volvo. Then the next part was to find the numerical amounts for the research and development and the amortization of it for Volvo. The third part was to compare the percentages we found in part 2 and compare them to a United States company and their percentage.

In this case, we found that the different standards did not the effect the percentage of Research & Development costs to net sales. I found this to be somewhat surprising because I figured the International Rule would help the non-American companies to be able to amortize some developing costs if they could prove the slightest economic benefit in the future of the find.

a. The 2009 income statement shows research and development expenses of SEK 13,193 (millions of Swedish Krona). What types of costs are likely included in these amounts?

The Volvo Group is a Swedish company that manufactures commercial vehicles. In the introduction of the case, it states that Volvo has recently been focusing on technical breakthroughs focused largely on reducing environmental impact and meeting future emissions and other regulations globally. In the research and development expense, you would probably find many researches expense for making greener cars and trucks and also expenses for developing greener parts for the vehicles. Depending on any regulations that are in place, they also may be working on other projects to modernize their products and keep them up-to-date and up to code in every country they sell in.

b. Volvo Group follows IAS 38—*Intangible Assets*, to account for its research and development expenditures (see IAS 38 excerpts at the end of this case). As such, the company capitalizes certain R&D costs and expenses others. What factors does Volvo Group consider as it decides which R&D costs to capitalize and which to expense?

Volvo would have to consider the following factors in determining which costs to capitalize and which to expense. One factor would be would have to be considered is the cost apart of the research or development phase. If the cost was during the research phase, it is expensed. They also expense the cost that won't help the company in the future economically. If the expense was occurred during the development stage of a new product and Volvo can economically benefit it from in the future, then that expense can go into the intangible asset account and be capitalized.

c. The R&D costs that Volvo Group capitalizes each period (labeled Product and software development costs) are amortized in subsequent periods, similar to other capital assets such as property and equipment. Notes to Volvo's financial statements disclose that capitalized product and software development costs are amortized over three to eight years. What factors would the company consider in determining the amortization period for particular costs?

Volvo would first need to consider the useful life of the R&D costs per period, just like they do in the in the PPE accounts. Going back the b, this would be found by seeing the future economic benefit of the asset (software/technology in this case) and amortize it over its expect time that it will benefit the product.

d. Under U.S. GAAP, companies must expense all R&D costs. In your opinion, which accounting principle (IFRS or U.S. GAAP) provides financial statements that better reflect costs and benefits of periodic R&D spending?

I feel that US GAAP gives the company more conservative financial statements by expensing R&D costs. This could be beneficial for the company in trying to accurately account for all its expenses. In the IFRS case, they allow for companies to capitalized on some development costs, which if the companies can precisely declare that these costs will be beneficial for the future, they may capitalize. In theory, this would be amazing, but it is so hard to accurately declare that this development costs will be beneficial in periods to come. I believe the US GAAP policy gives companies more structure in their

R&D costs, which will help prevent companies capitalizing on costs that other companies would expense.

e. Refer to footnote 14 where Volvo reports an intangible asset for "Product and software development." Assume that the product and software development costs reported in footnote 14 are the only R&D costs that Volvo capitalizes.

    i. What is the amount of the capitalized product and software development costs, net of accumulated amortization at the end of fiscal 2009? Which line item on Volvo Group's balance sheet reports this intangible asset?

The software and development cost for 2009 is 25, 148 kr and the total software and development amortization is 13,739. The net software and development cost would 11,409 kr (25,148-13,739). This is reported under the assets on the balance assets specifically the intangible assets.

    ii. Create a T-account for the intangible asset "Product and software development," net of accumulated amortization. Enter the opening and ending balances for fiscal 2009. Show entries in the T-account that record the 2009 capitalization (capital expenditures) and amortization. To simplify the analysis, group all other account activity during the year and report the net impact as one entry in the T-account.

Software and Development
Account

12,381	
2, 602	
	3,126
	448
11,409	

The 12,381 kr was the beginning balance for product and software development for 2008, which will be the beginning balance for 2009. Then, we found that 2,602 kr is the capitalized amount for the period and the 3,126 kr is the amortized amount. The 448 kr is the plug to get to the final amount of 11,409 kr, which we found in the section before.

f. Refer to Volvo's balance sheet, footnotes, and the eleven-year summary. Assume that the product and software development costs reported in footnote 14 are the only R&D costs the Volvo capitalizes.

   i. Complete the table below for Volvo's Product and software development intangible asset.

(in SEK millions)	**2007**	**2008**	**2009**
1.) Product and software development costs capitalized during the year	2,057	2,150	1,858
2.) Total R&D expense on the income statement	11,059	14,348	13,193
3.) Amortization of previously capitalized costs (included in R&D expense)	2,357	2,864	3,126
4.) Total R&D costs incurred during the year=1 + 2 - 3	10,759	13,634	11,925

ii. What proportion of Total R&D costs incurred did Volvo Group capitalize (as product and software development tangible asset) in each of the three years?

Percentage of R&D occurred capitalized by Volvo for software and development	**2007**	**2008**	**2009**
	19.4% *2,057/10,759*	**15.8%** *2,150/13,634*	**15.6%** *1,858/11,925*

g. Assume that you work as a financial analyst for Volvo Group and would like to compare Volvo's research and development expenditures to a U.S. competitor, Navistar International Corporation. Navistar follows U.S. GAAP that requires that all research and development costs be expensed in the year they are incurred. You gather the following information for Navistar for fiscal year end October 31, 2007 through 2009.

(In US $ millions)	**2007**	**2008**	**2009**
Total R&D costs incurred during the year, expensed on the income statement	375	384	433
Net sales, manufactured products	11,910	14,399	11,300
Total assets	11,448	10,390	10,028
Operating income before tax	(73)	191	359

i. Use the information from Volvo's eleven-year summary to complete the following table:

(In SEK millions)	**2007**	**2008**	**2009**
Net sales, industrial operations	276,795	294,932	208,487
Total assets, from balance sheet	321,647	372,419	332,265

ii. Calculate the proportion of total research and development costs incurred to new sale from operations (called, net sales from manufactured products, for Navistar) for both firms. How does the proportion compare between the two companies.

Navistar	**2007**	**2008**	**2009**
Total R&D costs	375	384	433
Net sales	11,910	14,399	11,300
Proportion of R&D costs to net sales	3.15%	2.67%	3.83%
Volvo	**2007**	**2008**	**2009**
Total R&D costs	10,759	13,634	11,925
Net sales	276,795	294,932	208,487
Proportion of R&D costs to net sales	3.9%	4.6%	5.7%

Volvo seems to be increasing their proportion of R&D to net sales from 2007-2009 while Navistar is staying remotely the same. With that being said, the proportions are still very similar. Before finding the percentage it seemed that Volvo was going to be much more higher, but you to keep in mind that the net sales are much higher for Volvo than Navistar.

CASE VII: Tableau

Tableau is a computer software program that prides itself on being very user friendly and easy to use. This is a very well known program especially in the business and accounting world. In this case, I looked at the history of Tableau and also different scenarios that Tableau would be beneficial for an accountant. Tableau is so useful and I wish I could cover everything that it can do in this case, but that would be impossible.

Tableau has a very typically software program history as it was founded in the early 2000s by college students. The stated purpose of its finding was to be user friendly. After talking about its history and then talked about certain tools or knowledge a user would need to user this software.

After laying out what knowledge and tools were needed, I then listed different functions and scenarios Tableau would be helpful for an auditor, a tax consultant, and an advisor. I learned from this part is that Tableau can be useful across all spectrums of accounting and regardless if I go tax or audit I will more than likely use this program.

Lastly, I was given a task to write a letter to a partner in my accounting firm urging him/her to get Tableau to help in our practice. This was the easiest part since over the course of my investigation I was in awe of the many factors that Tableau has and how beneficial each were to a business and to an accountant. Also, this will improve client-to-accountant relation since Tableau will cut down on time for certain parts of the accounting process. Tableau is not only useful for accountants, but also for a corporation as a whole. In the case as a whole, I learned about and highlighted the benefits of the Tableau software in regards to the accounting profession.

1. Identify the history and purpose of this tool and describe, in general, how it is used to make business decisions. Be specific about what kind of technology platform is uses, etc. and other resources that need to be in place to fully utilize the functionality of the tool.

Tableau Software was founded in 2003 in Mountain View, California with the purpose of visual aid for exploring relational database and data cubes. A unique feature about Tableau is that it has a mapping function and able to plot latitude and longitude coordinates. When Tableau was founded the main purpose of the software was the make data understandable to everyone. Tableau founders fused together computer graphics and databases to give the software and unique and simple look that helps users understand the data with their own technology called VizQL (Visual Query Language). Companies from Alaska Airlines to Jack Daniels use Tableau in their day-to-day operations as well as small, local companies. Tableau has moved it operations to Seattle, Washington and to this day keeps developing new software for their customers. They state that it is important for them to keep growing and producing more technology that will make data presentations simpler to understand especially during this growing technological time.

2. What special skills are needed to use this tool to aid in business decision-making? How might a student like you gain those skills?

Tableau is very user-friendly software; this is something that the company prides itself on. I would believe student that has taken Accounting Systems (Accounting 310) or

Information Systems (MIS 309) would have the knowledge for this software. If this is not the case, there are Tableau courses that you can attend and get online if need be sponsored by the company.

3. How, specifically, would you use the tool in the following business settings? Create at least three specific scenarios for each category in which the tool would lead to efficiency and/or better effectiveness. Be sure to describe what kinds of data your tool would use for each scenario.

    a. Auditing

Tableau would be a very effective software system to use in the auditing department. One of the main benefits of Tableau for auditing is that it is very user friendly, which means that clients will understand the software and will not need a long learning period. This software will also make it easier to display data to clients since it takes data and puts it in a visual and more understanding form. These two features would make the relationship between the client and the auditor more transparent since the client would understand what the auditor was saying from these reports. Another factor in Tableau that will be helpful for auditors is the map software on it. This will make it easier to keep track of different entities for a business that are located in different areas. This will be very helpful for corporations that have multiple companies under them that are located in different states or countries. This is helpful because it will show what codes are specific for a certain generation.

b. Tax Planning

Taxation will also benefit from Tableau. Like with auditing, the map feature will be beneficial to help keep track of where different entities are located. This will be helpful with keeping track of different tax rates in different states or countries. Also Tableau can show a tax consultant and clients what amount of the tax is going to where. What I am by this it can breakdown the whole sum of the tax paid by the company and shows where each dollar is going. This can be beneficial if the company wants to cut their budget and can show what areas of the business are cumulating more tax than others and potentially could cut costs with this. Although having no tax is possible, it can present the data to see if the company is being taxed too much for or too little. Another very helpful tool in Tableau is with payroll. You can put in each employee and their salary and it gives you the net pay you must pay them, taking out the income tax for you. This would make it easier during payroll time and also during tax season for the company.

c. Financial Statement Analysis/Valuation/Advisory

Tableau has the ability to flag potential anomalies, which is very helpful in Advisory. This can flag potential fraud for a company, which is helpful since it is predicting something that is really hard for a person to predict. Tableau can also show the performance of the company over a period a time. This is helpful for a client because it is showing how well they are doing and can also show how they are performing in a particular market. Also in Tableau, it can calculate popular ratios too. Unlike other systems where you would have to calculate each part of the ratio before finding the actual rate, Tableau calculates everything for you with a click of a button. This saves time in the advising department especially if the client asks for multiple ratios for a report. If Tableau doesn't offer that particular ratio, you can simply program it to do so.

4. Write a few paragraphs to your future public accounting partner explaining why your team should invest in the acquisition of and training in this tool. Explain how the tool will impact the staffing and scope of your future engagements.

Mr. Smith,

I feel that my team and I would benefit from the use of Tableau in our practice. I feel this way because Tableau will help cut down on grunt work and also be very useful for our client as well. Tableau is very user friendly and safe to use and many corporations IT Department will already be capable to use it. It would help us rely our message to our client in an easier than and would also help us cut down on time spent putting reports together.

For our larger clients, it will help us keep their different entities separate. Tableau's main feature is a map database that can help us pinpoint different entities on the map, which will be helpful with the taxation of the company. This will also help them with their payroll period as Tableau has many payroll tools already in the software.

Smaller clients, as well, will benefit from Tableau. First and foremost, they will have an easier getting data uploaded and for us to look at it. Time is everything for a small company and the easier and less time consuming it is the better they are off.

For us having the ability to put together reports easier will also mean we will be able to have more clients. Also this will be a cost cutting effect too for our company. In this age, we have experienced an IT Revolution and the more techs savvy we become the more competitive our firm becomes too.

CASE VIII: Rite Aid

In this case, we got a glance at Rite Aid Corporations financial statements. This case focuses on the notes and long-term debt for the company. First, we looked at the different kind of notes and debts in the company, specifically in financial statement note 11. This is where I found that Rite Aid did not just have one kind; they have multiple kinds with different interest rates. This is because they take on these different notes and debts at different times so that means different interest rates.

We also calculated the total debt Rite Aid. By doing this we had to go into their financial statements and add it up because it was separated. It was separated into three parts that I talk about below in part B because they treat each part differently. After we established the different kinds and way they are different, we looked at three different notes. These notes were very different from each other but ultimately have the same effect on the financials.

I learned in this case that there are many kinds of notes and long-term debt a company can take on. With these different kinds a company can allocates them differently. Even the same kind of notes are allocated differently based on if they were sold at a discount, premium, or at market.

A. Consider the various types of debt described in note 11, Indebtedness and Credit Agreement.

i. Explain the difference between Rite Aid's secured and unsecured debt. Why does Rite Aid distinguish between these two types of debt?

These two types of debt need to be separated because a company will account for them differently. Secured debt is debt that has collateral attached it for fallback, while unsecured does not. The two should be separated because sometimes-different percentages and allocations are used for them.

ii. What does it mean for debt to be "guaranteed"? According to note 11, who has provided the guarantee for some of Rite Aid's unsecured debt?

Rite Aid Company is actually a parent company to some of the under companies under the Rite Aid umbrella. Rite Aid as a parent company has extended the guaranteed unsecured debt to some other companies they operate under them therefore they need to record these debts differently than others extended.

iii. What is meant by the terms "senior," "fixed-rate," and "convertible"?

Senior debts are priority debts especially if the company starts liquidizing. If a company liquidizes, senior debts would be paid first before any other debts on the books. Fixed-rate debts are exactly as they sound; they are debts that have a fixed interest rate over the debt's life. A convertible bond is a bond that can be converted to other securities.

iv. Speculate as to why Rite Aid has many different types of debt with a range of interest rates.

There are two main reasons why Rite Aid would have different types of debt and different rates. The first one is simply that debt is issued at different times and there are different interest rates given the period of time it was issued. Rite Aid also has different kinds of debt because it is a parent company and has many other companies under them and certain debts make sense for different companies.

B. Consider note 11, Indebtedness and Credit Agreement. How much total debt does Rite Aid have at February 27, 2010? How much of this is due within the coming fiscal year? Reconcile the total debt reported in note 11 with what Rite Aid reports on its balance sheet.

Rite Aid has a total of $6,370,899 in debt. The current debt portion of Rite Aid is $51,502. The total debt is the total of the current long-term debt, long-term debt, and lease financing obligations. All of these totals are found in note 11 of Rite Aid's financial statements.

C. Consider the 7.5% senior secured notes due March 2017.

i. What is the face value (i.e. the principal) of these notes? How do you know?

The face value of this note is $500,000. It is obvious because the carrying value of the note does not change from year to year of the financial statements of Rite Aid.

ii. Prepare the journal entry that Rite Aid must have made when these notes were issued.

Cash	500,000	
Notes Payable		500,000

This increases assets and also liabilities, so it does not affect net income.

iii. Prepare the annual interest expense journal entry. Note that the interest paid on a note during the year equals the face value of the note times the stated rate (i.e., coupon rate) of the note.

Interest Expense	37,500	
Cash		37,500

This decreases assets and increases liabilities, so it will decrease net income.

iv. Prepare the journal entry that Rite Aid will make when these notes mature in 2017.

Notes Payable	500,000	
Cash		500,000

This will decrease assets and decrease liabilities, so it will have no affect on net *income.*

D. Consider the 9.375% senior notes due December 2015. Assume that interest is paid annually.

i. What is the face value (or principal) of these notes? What is the carrying value (net book value) of these notes at February 27, 2010? Why do the two values differ?

The face value of the note is $410,000. The carrying value of the note is $405,951. The difference between the two is because there is an unamortized discount attached this note. This means the note was issued at a discount and not the entire discount has been amortized yet.

ii. How much interest did Rite Aid pay on these notes during the fiscal 2009?

Rite Aid will pay $38,348 of interest during 2009.

iii. Determine the total amount of interest expense recorded by Rite Aid on these notes for the year ended February 27, 2010. Note that there is a cash and a noncash portion to interest expense on these notes because they were issued at a discount. The noncash portion of interest expense is the amortization of the discount during the year.

This total for Rite Aid would $39,143, which includes the total from ii and also $705 of amortized discount that needs to be recognized for this period.

iv. Prepare the journal entry to record interest expense on these notes for fiscal 2009. Consider both the cash and discount (noncash) portions of the interest expense from part iii above.

Interest Expense	39,143	
Discount of Note Payable		705
Cash		38,438

This will decrease assets and increase liabilities, so it will decrease net income.

v. Compute the total rate of interest recorded for fiscal 2009 on these notes.

The interest rate would be 9.659% (39,143/405,246) for the year of 2009.

E. Consider the 9.75% notes due June 2016. Assume that Rite Aid issued these notes on June 30, 2009 and that the company pays interest on June 30th of each year.

i. According to note 11, the proceeds of the notes at the time of issue were 98.2% of the face value of the notes. Prepare the journal entry that Rite Aid must have made when these notes were issued.

Cash	402,620	
Discount on Notes Payable	7,380	
Notes Payable		410,000

This will increase assets and increase liabilities, so there will be no affect on net income.

ii. At what effective annual rate of interest rate were these notes issued?]

These notes have an annual interest rate of 10.12%

iii. Assume that Rite Aid uses the effective interest rate method to account for this debt. Use the table that follows to prepare an amortization schedule for these notes. Use the last column to verify that each year's interest expense reflects the same interest *rate* even though the *expense* changes.

Date	*Interest Payment*	*Interest Expense*	*Bond Disc. Amortization*	*New Book Value of Debt*	*Effective Interest Rate*
June 30, 2009	0	0	0	$402,620	0
June 30, 2010	$39,975	$40,750	$775	$403,395	10.12%
June 30, 2011	$39,975	$40,828	$853	$404,248	10.12%
June 30, 2012	$39,975	$40,915	$940	$405,188	10.12%
June 30, 2013	$39,975	$41,010	$1,035	$406,223	10.12%
June 30, 2014	$39,975	$41,115	$1,140	$407,363	10.12%
June 30, 2015	$39,975	$41,230	$1,255	$408,618	10.12%
June 30, 2016	$39,975	$41,357	$1,382	$410,000	10.12%

iv. Based on the above information, prepare the journal entry that Rite Aid would have recorded February 27th, 2010, to accrue interest expense on these notes

Interest Expense	27,167	
Discount on Notes Payable		517
Cash		26,650

This will decrease assets and increase liabilities, so it will decrease net income.

v. Based on your answer to part iv, what would be the net book value of the notes at February 27th, 2010?

The net book value at February 27th 2010 is $403,137.

CASE IX: Merck & Co., Inc.

In this case I examined the stockholder's equity section of Merck & Co., Inc. Merck is global-research pharmaceutical company for human and animal health research. We mainly focused at the common stock portion of the stockholder's equity to see how it affects Merck's financial statements.

Common stock is usually issued by a company to raise capital, which the issuance of these stocks, investors also receive voting rights on a board that can dictate how the company should perform business.

We first looked at how many shares Merck could issue and how many were. We then looked at their treasury stock and found how many were outstanding by deducting what they had in reserve from the number issued. Merck also has a par value of $0.01 for their stocks and we calculated how much they had of that in the treasury. Then we looked at how much capitalization Merck had by the end of the year stock price.

Next, I discussed the reasoning behind common and treasury stock and why companies should issue common stock and also why they buy back treasury stock. I then lay out how this affects their Earnings per Share and how this makes them competitive on the stock market. We also calculated how much dividends payable the company has based on the dividends declared and how much cash was issued for the dividends.

Lastly, we looked at many different dividends related ratios from 2006 and 2007 and analyzed the changes between the periods. We see that many numbers change between the two periods and we get to see how those changes affect the ratios.

This whole case gave me a better understanding the precise measures a company does by issuing stock and buying it back. At first, I thought it was a very random event that a company did when they wanted to but at the end I realized there are huge reasons on why they would issues stock and even why they would buy it back.

h. Consider Merck's common shares.

i. How many common shares is Merck authorized to issue?

Merck has authorized 5,400,000,000 shares to issue.

ii. How many common shares has Merck actually issued at December 31, 2007?

Merck has only issued 2,983,508,675 shares

iii. Reconcile the number of shares issued at December 31, 2007, to the dollar value of common stock reported on the balance sheet.

Merck has a $0.01 par value of these shares so they would report $29,835,087 on their balance sheet for these shares.

iv. How many common shares are held in treasury at December 31, 2007?

Merck has 811,005,791 shares in the treasury at the end of 2007.

v. How many common shares are outstanding at December 31, 2007?

Merck has 2,172,502,884 shares outstanding and you find this number by subtracting the treasury shares from the shares issued amount.

vi. At December 31, 2007, Merck's stock price closed at $57.61 per share.

Calculate the total market capitalization of Merck on that day.

Merck would record $125,157,891,147 for total market capitalization.

c. Why do companies pay dividends on their common or ordinary shares? What normally happens to a company's share price when dividends are paid?

Companies pay dividends on their common or ordinary shares for many reasons.

One reason is that it makes their shares more desirable on the market. Investors will invest more in companies if they know they will get dividends back. This also shows that the company is doing well and can afford to give dividends back to investors. It shows there is no financial situation that would prevent them to not pay that money and focus on something else inside the company. After dividends are paid, company's share prices go down. This is a normal occurrence because the way the share price is calculated is affected when the company relieves itself of some liquid assets. When they pay the dividends the future cash flows are affected because of less money circulating in the company, causing the shares to become lower, but overtime will rise to or above the price they were originally.

d. In general, why do companies repurchase their own shares?

There are many reasons why a company would buy back their own shares. One reason would be to increase their Earnings per Share (EPS). With less shares outstanding, they can pay more to other investors. This was seen in part a(iv) of this case. EPS is calculated by dividing Net Income by Outstanding Shares, which shrinks when a company buys back their own. Also, it can be for more control of the company. When a company issues shares, they usually come with a voting power for the company and how it should be run. If the company buys back certain shares, they can gain more control and majority in the voting process and can be less reliable on investors' opinions.

e. Consider Merck's statement of cash flow and statement of retained earnings. Prepare a single journal entry that summarizes Merck's common dividend activity for 2007.

Dividends Declared	3,310,700,000	
Cash		3,307,300,000
Dividends Payable		3,400,000

g. During 2007, Merck repurchased a number of its own common shares on the open market.

i. Describe the method Merck uses to account for its treasury stock transactions.

Merck uses the cost method because they are recording the treasury stock for how much they repurchased the stock instead of par value of the stock. This will help the company keep tabs on how much they spent on the stock and if and when they allocate it again, it will also be beneficial to see how much they gain or loss from this buyback.

ii. Refer to note 11 to Merck's financial statements. How many shares did Merck repurchase on the open market during 2007?

Merck repurchased 26,500,000 shares of stock. You find this by taking the end of 2006 shares and deducting that number from the end of 2007 shares in the treasury.

iii. How much did Merck pay, in total and per share, on average, to buy back its stock during 2007? What type of cash flow does this represent?

In Merck's statements we see that they used $1,429,700,000 in repurchasing treasury stock. The average Merck spent per share is $53.95 and you get that by dividing the amount used to buy back the shares and the number of shares Merck bought back. This is a financial cash flow.

iv. Why doesn't Merck disclose its treasury stock as an asset?

Any company should never record treasury stock as an asset. This is because an asset is defined as something that could have future economic value and treasury stock does not. Treasury stock is a contra-equity, which means it's an equity account, but it actually lowers total equity inside of raising it. It also has a normal debit balance like assets, too.

h. Determine the missing amounts and calculate the ratios in the tables below. For comparability, use dividends paid for Merck rather than dividends declared. Use the number of shares outstanding at year-end for per-share calculations. What differences do you observe in Merck's dividend-related ratios across the two years?

(in millions)	Merck 2017	Merck 2016
Dividends Paid	$3,3007.3	$3,322.6
Shares Outstanding	2,172,502,884	2,167,785,445
Net Income	$3,275.4	$4,433.8
Total Assets	$48,350.7	$44,569.8
Operating Cash Flows	$6,999.2	$6,765.2
Year-end Stock Price (given)	$57.61	$41.94
Dividend per Share	$1.52	$1.53
Dividend Yield	2.64%	3.65%
Dividend Payout	100.97%	74.94%
Dividends to Total Assets	6.84%	7.45%
Dividends to Operating Cash Flows	47.25%	49.11%

Merck's dividend per Share remains constant over the two years, however many of the other dividend related ratios are different. The dividend yield drops 1% between the two years. This has to do with the Share price decreasing. Even though it only decreased by a penny, it still caused the dividend yield to drop. The Dividend payout was extremely bigger in the 2007, but is correlated with the net income dropping and the dividend paid remaining around the same from the previous year. The Total Assets to Dividends dropped by around a percent because Merck acquired more assets in the period than they had in 2006. The Dividends to Operating Cash Flows decreased because the Operating Cash flows increased from 2006 and 2007 and the dividends paid remained around the same. The reasons there were fluctuations are that the Net Income dropped by 1.2 billion, Total assets increased by 4 million, operating cash flows increased by 200 million, and dividends paid remained around the same.

CASE X: State Street Corporation

In this case, we looked at the financials for State Street Corporation. State Street is a prominent financial holding company in the United States. We were asked to look the securities the company has invested in. These securities were split into the three categories of investments: trading, available-for-sale, and held-to-maturity. In this case, we looked at the difference between the three and how they would affect the income statement and the company's equity.

At the beginning, we defined each of the securities. Then we determined when to use fair value adjustments. The accounting is different for each type and it depends on which type the manager labels them when they purchase them. Since the security market is very fluid, there is always difference over time with the how much they are actually worth in the market and to the company.

After we established the traits for each type, we looked at State Street's 2012 financials and determined what the numbers meant. This is where we went really hands on and investigated each to find out how much the securities were purchased at and the market of each one.

With available for sale and trading securities, we had to find the unrealized holding gain/loss that were associated with these. Available for sale's unrealized holding gain/loss affects equity while trading securities' affects income. We did simple journal entries and plug figure to determine how much State Street had that year and also found out that State Street realized $55,000,000 of the holding gain/loss during the 2012 fiscal year.

This case was very helpful because it showed us the financials of a financial company that works with many securities. Securities are a very difficult element of accountancy and it comes with a lot of restrictions and regulations that are in effect because of GAAP and this case along with my Intermediate II coursework really helped me familiarize myself with them.

a. Consider trading securities. Note that financial institutions such as State Street typically call these securities "Trading account assets."

i. In general, what are trading securities?

A trading security is either a debt or equity security that companies hold for a short period of time for the purpose of trading them for profit. These are mainly done through an organized stock exchange. If there is a change of fair value during the period the company is holding, there is a gain or loss recognized in the income statement.

ii. How would a company record $1 of dividends or interest received from trading securities?

A company would debit cash for $1 and credit dividends/interest revenue for $1.

iii. If the market value of trading securities increased by $1 during the reporting period, what journal entry would the company record?

The company would record the trading security for $1 and unrealized holding gain/loss-income for $1.

b. Consider securities available-for-sale. Note that State Street calls these, "Investment securities available for sale."

i. In general, what are securities available-for-sale?

Available-for-sale securities are debt or investments that companies for a longer period of time. The purpose of them is to not sell them, but this is an option for these securities. With that being said they are not to be held for profit. They are considered to be in the middle of time being held. They are monitored critically on the balance sheet.

ii. How would a company record $1 of dividends or interest received from securities available-for- sale?

A company would debit cash for $1 and credit dividend/interest revenue for $1.

iii. If the market value of securities available-for-sale increased by $1 during the reporting period, what journal entry would the company record?

A company would debit investment security available-for-sale for $1 and credit to unrealized holding gain/loss-equity for $1.

c. Consider securities held-to-maturity. Note that State Street calls these, "Investment securities held to maturity."

i. In general, what are these securities? Why are equity securities never classified as held-to- maturity?

Held-to-maturity securities are debt securities that are held by a company until they are mature. They are to be held until they reach full maturity. They are never equity securities because equity securities do not have a maturity date.

ii. If the market value of securities held-to-maturity increased by $1 during the reporting period, what journal entry would the company record?

There is no entry for this.

d. Consider the “Trading account assets” on State Street’s balance sheet.

i. What is the balance in this account on December 31, 2012? What is the market value of these securities on that date?

On December 31, 2012, there is $637,000,000 in the trading account. This is market value because these securities are always on the books for fair value.

ii. Assume that the 2012 unadjusted trial balance for trading account assets was $552 million. What adjusting journal entry would State Street make to adjust this account to market value? Ignore any income tax effects for this part.

Trading Securities	$85	
Unrealized holding gain/loss-income		$85

e. Consider the balance sheet account “Investment securities held to maturity” and the related disclosures in Note 4.

i. What is the 2012 year-end balance in this account?

The year-end balance for the held to maturity securities is $11,379,000,000.

ii. What is the market value of State Street’s investment securities held to maturity?

The market value for the held to maturity securities is $11,661,000,000.

iii. What is the amortized cost of these securities? What does "amortized cost" represent? How does amortized cost compare to the original cost of the securities?

The amortized cost of these securities is $11,379,000,000. The amortized cost represents the change in the carrying value since the company bought the securities. The amortized cost is higher than the original cost of these securities.

iv. What does the difference between the market value and the amortized cost represent? What does the difference suggest about how the average market rate of interest on held-to-maturity securities has changed since the purchase of the securities held by State Street?

Market value represents how much the company would receive if they were to sell these securities. The amortized cost is the cost left from the purchase price of these securities minus the amount deducted over its life. The market rate is above what the security is stated. This means market rates have decreased and now these bonds are selling at a higher premium.

f. Consider the balance sheet account "Investment securities available for sale" and the related disclosures in Note 4.

i. What is the 2012 year-end balance in this account? What does this balance represent?

$109,162,000,000 is the 2012 year-end balance for the available for sale securities. This is the market value of these securities since they are adjusted to market value because their purpose is for selling.

ii. What is the amount of net *unrealized* gains or losses on the available-for-sale securities held by State Street at December 31, 2012? Be sure to note whether the amount is a net gain or loss.

The net unrealized gain is $1,119,000,000.

iii. What was the amount of net *realized* gains (losses) from sales of available-for-sale securities for 2012? How would this amount impact State Street's statements of income and cash flows for 2012?

In 2012, State Street recognized a $55,000,000 realized gain from the available for sale securities. This increased income and the cash flow from investing for the company in 2012.

g. State Street's statement of cash flow for 2012 (not included) shows the following line items in the "Investing Activities" section relating to available-for-sale securities (in millions): Proceeds from sales of available-for-sale securities $ 5,399
Purchases of available-for-sale securities $60,812

i. Show the journal entry State Street made to record the purchase of available-for-sale securities for 2012. (in millions)

Investment securities available for sale $60,812

Cash $60,812

ii. Show the journal entry State Street made to record the sale of available-for-sale securities for 2012. Note 13 (not included) reports that the available-for-sale securities sold during 2012 had "*unrealized pre-tax gains of $67 million as of December 31, 2011*." *Hint:* be sure to remove the current book value of these securities in your entry.

Cash $5,399

Unrealized holding gain/loss-equity $67

Realized holding gain $55

Debt Investment $5,411

iii. Use the information in part *g. ii* to determine the original cost of the available-for-sale securities sold during 2012.

From the information in g(ii) We can tell that the original cost of the securities is $5,411 because when you sell a security you always credit the original cost of the security to get it off the books.

CASE XI: ZAGG Inc.

In this case, we looked at the 2011 and 2012 financials for ZAGG Corporation. ZAGG makes plastic protective covers for watches and other mobile devices. They also have patented the invisibleSHIELD that is a protective cover for iPhones and other smart phones.

In this case our main objective was to investigate the income tax expense and deferral accounts of ZAGG. Under GAAP, a company does not have to pay income tax on all its income during the year, so we also traced by what they deferred and what was deferred in previous periods for ZAGG. GAAP has many requirements on how a company can report their income tax expense and this case really highlighted the intricate details of their requirements.

We began by distinguishing between the different types of income. A company has a book income and a taxable income and they are different based on certain transactions that occur during the year for a company. Because of these differences, there are also different tax rates for company's: statutory or the amount stated by the government for the company to pay and effective the percentage they actually pay. These are different because there is a difference in the income on the books and the income that is actually being taxed.

We then looked at the scenarios that would the book income and the taxable income. There are permanent ones that affect it for that year and only that year and there are deferrals, which would change that year's income, but also affect future year's income. These can either be deferred tax assets or deferred tax liabilities. Deferred tax assets are basically pre-paid taxes to a degree. They are taxes paid on items can and will be deferred in future periods. Deferred tax liabilities are deferred to future periods to be taxed upon, but are already recognized in this period's financials. Below I go into more detail on the affects and differences of the two. We also looked at deferred tax valuation allowance for deferred tax assets below too.

After we established the foundation of income tax expense we then looked at ZAGG's financial statements to harvest the amounts for income tax payable, income tax expense, and net deferred income tax. This process made us calculate the amounts and prepare the journal entries ZAGG would have made to record these. We also found the effective tax rate for ZAGG based on what the paid and the taxable income they had. After we split the deferred income tax amounts into their two categories listed above: assets and liabilities. After we did this we saw what affect it had on ZAGG's financials. After splitting them, we split the assets even further into current and noncurrent assets and stated where they would be reported on the financial statements.

a. Describe what is meant by the term book income? Which number in ZAGG's statement of operation captures this notion for fiscal 2012? Describe how a company's book income differs from its taxable income.

Book income is the income that an entity reports within their financial statements. This is different than taxable income normally due to deferred tax assets and deferred tax liabilities. However, the deferred amounts are already on the books, but must be evaluated to determine the amount a company pays income tax on.

b. In your own words, define the following terms:

i. Permanent tax differences (also provide an example)

Permanent tax differences are amounts that cause the book income and taxable income to be different. Unlike deferred or temporary tax differences, these amounts will never be prone to taxes. An example of this would be a fine a company has to pay. A fine is an example that effects a company's financial statements but not their taxable income because this amount would not be taxed during that year and cannot be deferred to another year.

ii. Temporary tax difference (also provide an example)

Temporary tax differences are amounts that cause the book income and taxable income to be different. Unlike permanent tax differences, these amounts have an effect on the tax a company pays. This could increase the amount they pay during that year or will cause future years to be increased depending if it's a deferred tax asset or deferred tax liability. An example would be pre-paid rent. This is an example of a deferred tax asset because a company would pay taxes on this amount the year it was received, but would not record it as revenue until it is incurred. When it is incurred though, it would not be in taxable income since the company has already paid taxes on the amount.

iii. Statutory tax rate

Statutory tax rate is the legal tax rate a company is inclined to pay. This rate fluctuates based on the income a company reports. The tax rate has different levels based on this amount.

iv. Effective tax rate

Effective tax rate is the average tax rate a company pays overtime. You calculate the amount by dividing the amount of income tax paid by the taxable income.

c. Explain in general terms why a company reports deferred income taxes as part of their total income tax expense. Why don't companies simply report their current tax bill as their income tax expense?

Simply, the companies report deferred income tax as part of their total income tax expense to match it during the period they earned or in this case deferred. In ASC 740, it states that a company must report standards for the effects of income taxes that result from a company's activities during the current and preceding years. Companies do not report their current tax bill as their income tax expense because there are deferred amounts that will lower or raise that amount. If the company has a lot of deferred tax liabilities, then the amount they would have paid is going to be lowered because they are deferring these amounts into the future. If a company has a lot of deferred tax assets, the company would actually be paying more because they are paying for other items that have not been recognized as revenue yet. Also with deferred tax assets, when the revenue is recognized it will reduce the amount of tax a company will pay in the future periods because once that amount is recorded as a revenue, it will effect the income on the books, but will not be in the equation for taxable income since the company has already paid taxes on the amount. The opposite is true for deferred tax liabilities; once the amount is recognized it will raise the amount of income that will be taxed for a future period and so would cost the company more in the future. Since these are deferrals, they are reported in the income tax expense because once a company recognizes these amounts as a deduction or increase in the future they must deduct the amounts from the deferral accounts. This goes back to ASC 740 where it states they must report any activity that affects the income tax expense and these previous years deferral will affect them and must be recorded so these accounts are stated with income tax expense for the purpose of seeing what happens with the deferral accounts during the current tax period and seeing how it affects the income tax expense. Depending on the circumstances, this could raise or lower the income tax expense depending if a company will recognize more deferral tax assets or deferral tax liabilities. Whenever they recognize a amount that's deferred, they must deduct it from the deferral account, another reason why a company must report these amounts with income tax expense. A company cannot simply just lower or raise what they pay without a recognition because these do affect taxable income, but must be reported separately instead of just raising or lowering the amount.

d. Explain what deferred income tax assets and deferred income tax liabilities represent.

Give an example of a situation that would give rise to each of these items on the balance sheet.

A deferred income tax asset is an amount a company can deduct in the future. This occurs mainly when cash is received for a service that is already on the books while a company is paying their income taxes, but has not recognized this as revenue yet. An example of this would be prepaid rent. A company would already have received the money for the rent, but they would not recognize it as revenue until the month or year they earn it. Since the company already records this cash, the company will pay income tax on it during the period when they received it. In the period where there officially earn this money and record it as revenue, they would not pay income tax on it and they would take it the amount out when computing taxable income. A deferred income tax liability is an amount that a company will pay in the future. This is characterized as a future tax obligation. An example would be an installment sale where companies sell their product on credit and the customer will pay off their debt to the company over time. Under accounting rules, the company is allowed to recognize full income for the installment sale of the product, but wouldn't have to pay income tax on the sale until they receive actual money for it. This can be deferred over many tax periods, and once the customer sends the company a portion or all they owe, they would reduce the deferred income tax liability account and then the company would pay income tax on the amount.

e. Explain what a deferred income tax valuation allowance is and when it should be recorded.

Deferred income tax valuation allowance is a balance sheet item that offsets a portion of a value of a company's deferred tax asset. This is because the company doesn't expect to be able to realize the portion of the deferred tax asset account. This occurs when a company experiences a loss for a period and wants to spread out the loss over the next few years, but only if they experience a high enough gain. This also comes back to the C-level positions of the company to put in place this account because it can only have a value if there is more than a 50% chance that the company will not be able to realize that portion of deferred tax assets.

f. Consider the information disclosed in Note 8 – Income Taxes to answer the following questions:

i. Using information in the first table in Note 8, show the journal entry that ZAGG recorded for the income tax provision in fiscal 2012?

Income tax expense	9,393,000	
Net deferred income tax	8,293,000	
Income Tax Payable		17,686,000

ii. Using the information in the third table in Note 8, decompose the amount of "net deferred income taxes" recorded in income tax journal entry in part *f. i*. into its deferred income tax asset and deferred income tax liability components.

Net deferred income tax is composed of 2 different types of deferred taxes: deferred tax liabilities (DTL) and deferred tax assets (DTA). DTL have a normal credit balance while DTA have a normal debit balance. For the DTA, the ending balance for 2011 was \$6,300,000 and the end for 2012 was \$14,302,000 so the there was an \$8,002,000 increase in the DTA for the year 2012. The DTL went from \$1,086,000 in 2011 to \$794,000 in 2012. This effect would've been debited for \$292,000. However, when you add these numbers you get a net effect of \$8,294,000, but this is because the case is giving us the statements in \$1,000s and there is a rounding error. We do know the Income Tax Expense and the Income Tax Payable from prior statements so we know the plug for net deferred income tax.

iii. The second table in Note 8 provides a reconciliation of income taxes computed using the federal statutory rate (35%) to income taxes computed using ZAGG's effective tax rate. Calculate ZAGG's 2012 effective tax rate using the information provided in their income statement. What accounts for the difference between the statutory rate and ZAGG's effective tax rate?

As stated before, the effective income tax rate can be different from the statutory rate. This is because of the taxable income and the deferred tax liabilities and assets. In 2012, ZAGG paid \$9,393,000 of taxes. ZAGG's taxable income is found to be around \$23,898,000 (This is found by taking the number in the statutory column and dividing it by 35% or the statutory rate). The effective income tax rate would be 39.31%.

iv. According to the third table in Note 8 – Income Taxes, ZAGG had a net deferred income tax asset balance of $13,508,000 at December 31, 2012. Explain where this amount appears on ZAGG's balance sheet.

The $13,508,000 would be recorded on the balance is two separate accounts: current and noncurrent. These are subsections of the Deferred incomes tax asset balance. The current part would have $6,912,000 and would under the Deferred Tax Assets account and the noncurrent part would be under long-term assets for $6,596,000. The current portion will only affect the next year while the noncurrent portion will affect future years.

CASE XII: Apple, Inc.

In this case, we are focusing on the revenue recognition principle a company has to follow. The company up for review is Apple Inc. Apple is a huge household name that sells many items like iPhones, Macs, iPods, as well as accessory for these items. The main point of this case was to identify the principles a company has to follow with revenue and how Apple utilizes these principles with their many items they sell on a daily bases.

First and foremost, we identified the difference between revenue and gains. This was something that before I was an accounting I had trouble to wrap my head around because they seem so similar. Because they are somewhat similar, many people think they are accounted for the same, but they are not. After deciphering the difference between the two we looked at the ASC 606 Statement that FASB and IASB released a joint statement on the revenue recognition principle. It lays out 5 steps a company must follow to be allowed to account for revenue.

I then discussed what a multiple-element contract is for a company and the manager's role in recording it correctly. A manager's role is really important because it makes sure that Apple's revenues are correct under the matching principle; Apple may receive money for an item or service but it would not be earned revenue yet.

I was giving four items that Apple sells and how they would account for it. Even though Apple is the vendor, they would account for these differently based on the elements of the contract, when the item would be received, and if a third-party is in the equation as well.

From this case, I learned the obstacles a company must go through to be able to record revenue from a sale. This isn’t recorded when money is received for a certain item or service, it has to with the guidelines setup by FASB and also calls for certain managers to be ethical and record the revenue when it is earned so their financials are accurate.

a. In your own words, define "revenues." Explain how revenues are different from "gains."

Revenue is any amount that is earned by a company from day-to-day operations while a gain is any amount earned by a company that was not from the day-to-day operations. Gains are usually indirect while revenue is direct. Revenue is income earned for a company during a period of time while a gain is usually realized after actions are taken.

b. Describe what it means for a business to "recognize" revenues. What specific accounts and financial statements are affected by the process of revenue recognition? Describe the revenue recognition criteria outline in the FASB's Statement of Concepts No. 5.

In ASC 606, FASB and IASB jointly issued a process that companies should follow to recognize revenue. The first step is identifying the contract with the customer. Once the contract has been identified that must then identify the performance obligations of the contract. After the obligations have been agreed upon, the two parties must agree on a price for the contract and its substance. Step 4 is to allocate the transaction price to the performance obligation. However, this is not when a company recognizes revenue. Revenue is recognized when the entity satisfies a performance obligation and they recognize it for the amount agreed upon to satisfy the obligation in the contract. Specific accounts related to revenue recognition would be accounts receivable as a debit and specific revenue would be credited. This would also be recognized on the Income Statement under the sales section or other revenue and gains if it were not part of the company's normal operations. When the revenues are established they would be matched with expenses. The expenses accounts would be linked to any transaction that would be in the Sales Revenue category.

c. Refer to the Revenue Recognition discussion in Note 1. In general, when does Apple recognize revenue? Explain Apple's four revenue recognition criteria. Do they appear to be aligned with the revenue recognition criteria you described in part b, above?

Apple recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection for the item or performed service is probable. These do apply from part B by covering Steps 1 through 4 that ASC 606 outlines for companies. When the persuasive evidence is probable, Apple has created a contract with the customer.

d. What are multiple-element contracts and why do they pose revenue recognition problems for companies?

Multiple-element contracts are contracts that are agreed upon with a company and customer that multiple parts to it. The main issue with these contracts is how to allocate the overall amount of the contract to each specific obligation. Also, other wrinkle that is added is when the different elements are completed at different times. So, therefore, the problem arises on what amount should a company record under Sales especially if parts of the contracts are long-term. The accrual method of accounting states that revenue should be recorded during the time the obligation is satisfied.

e. In general, what incentives do managers have to make self-serving revenue recognition choices?

Managers at Apple recognize revenue from the sale of actual products like iPhones and Macs and also the software that is bundled in with these products. They also recognize revenue from third parties that sell digital content on the iTunes Store. It is tricky for managers to make decisions with this revenue because each cases: products, software, third parties, revenue is officially earned at different times. It is very easy for managers to just record revenue when Apple receives the cash. However, this violates the matching principle of accounting where revenue is recorded when it is actually earned. Managers have to make these choices to keep true to GAAP and to the investors who want to invest in Apple.

f. Refer to Apple's revenue recognition footnote. In particular, when does the company recognize revenue for the following types of sales?

i. iTunes songs sold online.

Even though these are listed on an Apple, these songs are not property of Apple. This is the third-party scenario that was discussed in e. The third-party actually sets the prices of the songs. Apple would account for these on a net basis. They would only recognize revenue commission rather than revenue. The commission would also be part of sales in their Consolidated Statement of Operations. The sales prices paid by the customer is sent by Apple to the third party and isn't part of Apple's revenue.

ii. Mac-branded accessories such as headphones, power adaptors, and backpacks sold in the Apple stores. What if the accessories are sold online?

These are actually products of Apple rather than of a third party. Apple controls the pricing of these inventory items. Apple would recognize a sale and also a decrease in inventory. They would also recognize a cost that actually went into making the product and sales minus that cost would be the revenue that Apple records. This amount for the accessory is reflected in the contract agreed upon between Apple and the customer.

iii. iPods sold to a third-party reseller in India.

When Apple is selling to another party in India, they are still in charge of the price of the item. However, the revenue will be recorded once the Indian reseller receives it. When this when Apple has no risks attached to the goods anymore and officially out of their control. They will defer the revenue until then. This would affect inventory in shipping and unearned revenue. After the goods are received they would record sales and costs.

iv. Gift cards

Apple considers gift card revenue differently. Apple records this as deferred or unearned revenue. This is because the performance obligation has not been met yet. With a gift card, the performance obligation is not when the card in purchase but when the customer uses the gift card to buy an item. Once the customer uses the gift card to buy an item, that is when Apple records revenue for the gift card usage. Once the item is in the customer's hands and Apple does not have any risks associated with the transaction that is when Apple has satisfied the entire steps in ASC 606 and can record the revenue.