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A COMPILATION OF CASE STUDIES IN FINANCIAL ACCOUNTING

by
Hagen Brooks Gurley

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

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Advisor and First Reader: Dr. Victoria Dickinson

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Second Reader: Dr. Mark Wilder

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Abstract

The following exploratory project delves into relevant accounting concepts in today's economic and financial landscape. Using U.S. Generally Accepted Accounting Principles, the topics of financial reporting, deferred taxation, mergers and acquisitions, internal controls, financial ratio analysis, revenue recognition, inventory management and cost accounting, leases, and dissolution are investigated through the use of case studies. Over the course of the 12 cases presented here, the purpose is to provide a comprehensive understanding regarding the current landscape of accounting as it pertains to the topics mentioned above.

The cases were conducted under the direction of Dr. Victoria Dickinson in the Patterson School of Accountancy in conjunction with the Sally McDonnell Barksdale Honors College. The Honors College thesis requirement has been satisfied through the alternative thesis track provided to accountancy honors students. The 12 cases were completed on a biweekly basis through the fall and spring semesters with accounting professionals spending time with our class on the opposite weeks to provide real-world insight into the topics that we were researching in our case studies.

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Case Study 1
Home Theaters:

Financial Comparison of
Glenwood Heating, Inc. and Eads Heaters, Inc.
from an investment perspective

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1. Introduction

Glenwood Heating, Inc. and Eads Heaters, Inc. are competing companies based out of Colorado, United States of America, selling home heating units. The following financial statements and profitability analyses represent the companies' operations in year 20X1 and are presented to provide insight to potential investors.

2. Glenwood Heating, Inc.

a. Financial Statements

Glenwood Heaters, Inc. Statement of Retained Earnings For Year Ended December 31, 20X1	
Retained Earnings (Prior Fiscal Year End)	$0
Plus: Net Income	92,742
	92,742
Less: Cash Dividends	(23,200)
Retained Earnings (Current Fiscal Year End)	$69,542

Glenwood Heating, Inc. Balance Sheet December 31, 20X1		
Assets		
Current Assets		
Cash	$426	
Accounts Receivable, net	98,406	
Inventory	62,800	
Total Current Assets	$161,632	
Plant Assets		
Equipment and Buildings	$430,000	
Less: Accumulated depreciation	(19,000)	
Equipment and Buildings, net	411,000	
Land	70,000	
Total plant assets	$481,000	
Intangible Assets		$0
Total Assets		$642,632
Liabilities		
Current Liabilities		
Accounts Payable	$26,440	
Interest Payable	6,650	
Total current liabilities	$33,090	
Long-term Liabilities (net of current portion)		
Note Payable, 20 year, 7%	380,000	
Total Liabilities		$413,090
Equity		
Common Stock		$160,000
Retained Earnings		69,542
Total Equity		$229,542
Total Liabilities and Equity		$642,632

Glenwood Heating, Inc. Statement of Cash Flows For Year Ended December 31, 20X1		
Cash Flows from Operating Activities		
Net Income	$92,742	
Adjustments to reconcile net income to net cash provided by operating activities		
Income Statement items not affecting cash		
Depreciation Expense	19,000	
Changes in Current Assets and Current Receivables		
Increase in Accounts Receivable	(99,400)	
Increase in Inventory	(62,800)	
Increase in Allowance for Bad Debts	994	
Increase in Accounts Payable	26,440	
Increase in Interest Payable	6,650	
Net Cash Used by Operating Activities		($16,374)
Cash Flows from Investing Activities		
Cash paid for purchase of equipment	(80,000)	
Cash paid for purchase of land	(70,000)	
Cash paid for purchase of building	(350,000)	
Net Cash Used by Investing Activities		($500,000)
Cash Flows from Financing Activities		
Cash received from issuing stock	160,000	
Cash paid for dividends	(23,200)	
Cash received from note payable	400,000	
Cash paid for principal of note payable	(20,000)	
Net Cash Provided by Financing Activities		$516,800
Net Increase in Cash		$426
Cash balance at prior year-end		0
Cash balance at current year-end		$426

Glenwood Heating, Inc. Income Statement For Year Ended December 31, 20X1		
Sale		$398,500
Less: Sales discounts	$0	
Sales Returns and Allowances	(994)	(994)
Net Sales		397,506
Cost of Goods Sold		(177,000)
Gross Profit		$220,506
Operating Expenses		
Selling Expenses		
Depreciation Expense-Store Equipment	(9,000)	
Rent Expense-Leased Equipment	(16,000)	
Total Selling Expenses	($25,000)	
General and Administrative Expenses		
Depreciation Expense-Building	(10,000)	
Total General and Administrative Expenses	($10,000)	
Total Operating Expenses		($35,000)
Income from Operations		$185,506
Other Revenue and Gains (Expenses and Losses)		
Interest Expense		(27,650)
Other Operating Expenses		(34,200)
Income Tax Expense		(30,914)
Total other Revenue and Gains (Expenses and Losses)		($92,764)
Net Income		$92,742

b. Profitability Analysis

Profit Margin Ratio	23.33%
Gross Margin Ratio	55.47%
Return on Total Assets	14.43%
Return on Common Stockholders' Equity	40.40%

3. Eads Heaters, Inc.

a. Financial Statements

Eads Heaters, Inc. Statement of Retained Earnings For Year Ended December 31, 20X1	
Retained Earnings (Prior Fiscal Year End)	$0
Plus: Net Income	70,515
	70,515
Less: Cash Dividends	(23,200)
Retained Earnings (Current Fiscal Year End)	$47,315

Eads Heaters, Inc. Income Statement For Year Ended December 31, 20X1		
Sale		$398,500
Less: Sales Returns and Allowances	(4,970)	(4,970)
Net Sales		393,530
Cost of Goods Sold		(188,800)
Gross Profit		204,730
Operating Expenses		
Selling Expenses		
Depreciation Expense-Store Equipment	(20,000)	
Depreciation Expense-Leased Equipment	(11,500)	
Total Selling Expenses	(31,500)	
General and Administrative Expenses		
Depreciation Expense-Building	(10,000)	
Total General and Administrative Expenses	(10,000)	
Total Operating Expenses		(41,500)
Income from Operations		163,230
Other Revenue and Gains (Expenses and Losses)		
Interest Expense	(35,010)	
Other Operating Expenses	(34,200)	
Income Tax Expense	(23,505)	
Total other Revenue and Gains (Expenses and Losses)		(92,715)
Net Income		$70,515

Eads Heaters, Inc. Balance Sheet December 31, 20X1		
Assets		
Current Assets		
Cash	$7,835	
Accounts Receivable, net	94,430	
Inventory	51,000	
Total Current Assets		$153,265
Plant Assets		
Equipment and Buildings	522,000	
Less: Accumulated depreciation	(41,500)	
Equipment and Buildings, net		80,500
Land		70,000
Total plant assets		$550,500
Intangible Assets	0	
Total Assets		$703,765
Liabilities		
Current Liabilities		
Accounts Payable	$26,440	
Interest Payable	6,650	
Notes Payable	380,000	
Total current liabilities		$413,090
Long-term Liabilities (net of current portion)		83,360
Total Liabilities		$496,450
Equity		
Common Stock		160,000
Retained Earnings		47,315
Total Equity		$207,315
Total Liabilities and Equity		$703,765

Eads Heaters, Inc. Statement of Cash Flows For Year Ended December 31, 20X1		
Cash Flows from Operating Activities		
Net Income	$70,515	
Adjustments to reconcile net income to net cash provided by operating activities		
Income Statement items not affecting cash		
Depreciation Expense	41,500	
Changes in Current Assets and Current Receivables		
Increase in Accounts Receivable	(99,400)	
Increase in Inventory	(51,000)	
Increase in Allowance for Bad Debts	4,970	
Increase in Accounts Payable	26,440	
Increase in Interest Payable	6,650	
Net Cash Used by Operating Activities		($325)
Cash Flows from Investing Activities		
Cash paid for purchase of equipment	(80,000)	
Cash paid for purchase of land	(70,000)	
Cash paid for purchase of building	(350,00)	
Net Cash Used by Investing Activities		($500,000)
Cash Flows from Financing Activities		
Cash received from issuing stock	160,000	
Cash paid for dividends	(23,200)	
Cash paid for principal of lease agreement	(8,640)	
Cash received from note payable	400,000	
Cash paid for principal of note payable	(20,000)	
Net Cash Provided in Financing Activities		$508,160
Net Increase in Cash		$7,835
Cash balance at prior year-end		0
Cash balance at current year-end		$7,835

b. Profitability Analysis

Profit Margin Ratio	17.92%
Gross Margin Ratio	52.01%
Return on Total Assets	10.02%
Return on Common Stockholders' Equity	34.01%

4. Comparison and Investment Suggestions

Based on the financial statements, each company has its strengths and weaknesses. Eads Heaters, Inc. boasts a higher operating cash flow and cash balance, which contributes to its liquidity. Glenwood Heating, Inc., however, possesses the higher net income and retained earnings. In the profitability analysis, Glenwood Heating, Inc. fairs better overall than Eads Heaters, Inc., holding a higher profit margin ratio, gross margin ratio, return on total assets, and return common stockholders' equity. From an investment standpoint, Glenwood Heating, Inc. is the better company to invest in because of its higher overall net income, retained earnings, and profitability ratios.

5. Appendix

a. Glenwood Heating, Inc.

i. Transactions

Glenwood Heating, Inc. Chart of Accounts								
Cash	Accounts Rec	Allowance for	Inventory	Land	Building	Acc. Dep., building	Equipment	Acc. Dep., equipment
$160,000								
$400,000								
($420,000)				$70,000	$350,000			
($80,000)							$80,000	
			$239,800					
	$398,500							
$299,100	($299,100)							
($213,360)								
($41,000)								
($34,200)								
($23,200)								
		$994						
			($177,000)					
						$10,000		$9,000
($16,000)								
($30,914)								
$426	$99,400	$994	$62,800	$70,000	$350,000	$10,000	$80,000	$9,000

Glenwood Heating, Inc. Chart of Accounts							
Leased Equipment	Acc. Dep., Leased	Accounts Payable	Interest Payable	Note Payable	Lease Payable	Common Stock	Retained Earnings
						$160,000	
				$400,000			
		$239,800					
		($213,360)					
				($20,000)			
			$6,650				

Glenwood Heating, Inc. Chart of Accounts								
Dividends	Sales	Cost of Goods Sold	Bad Debt Exp.	Dep. Exp.	Int. Exp.	Other Oper. Exp.	Rent Exp.	Prov. Income Taxes
	$0	$0	$26,440	$6,650	$380,000	$0	$160,000	$0
	$398,500							
					$21,000			
						$34,200		
$23,200								
					$6,650			
			$994					
		$177,000						
				$19,000				
							$16,000	
								$30,914
$23,200	$398,500	$177,000	$994	$19,000	$27,650	$34,200	$16,000	$30,914

ii. Trial Balance

Glenwood Heating, Inc. Trial Balance December 31, 20X1		
Asset Accounts		
Cash	$426	
Accounts Receivable	99,400	
Allowance for Bad Debts		$994
Inventory	62,800	
Land	70,000	
Building	350,000	
Accumulated Depreciation, Building		10,000
Equipment	80,000	
Accumulated Depreciation, Equipment		9,000
Leased Equipment		
Accumulated Depreciation, Leased Equipment		
Liability Accounts		
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		
Equity Accounts		
Common Stock		160,000
Retained Earnings		
Dividends	23,200	
Sales		398,500
Cost of Goods Sold	177,000	
Bad Debt Expense	994	
Depreciation Expense	19,000	
Interest Expense	27,650	
Other Operating Expenses	34,200	
Rent Expense	16,000	
Provision for Income Taxes	30,914	
TOTALS:	$991,584	$991,584

b. Eads Heaters, Inc.

i. Transactions

Eads Heaters, Inc. Chart of Accounts								
Cash	Accounts Receivable	Allowance for	Inventory	Land	Building	Acc. Dep., building	Equipment	Acc. Dep., equipment
$160,000								
$400,000								
($420,000)				$70,000	$350,000			
($80,000)							$80,000	
			$239,800					
	$398,500							
$299,100	($299,100)							
($213,360)								
($41,000)								
($34,200)								
($23,200)								
		$4,970						
			($188,800)					
						$10,000		$20,000
($16,000)								
($23,505)								
$7,835	$99,400	$4,970	$51,000	$70,000	$350,000	$10,000	$80,000	$20,000

Eads Heaters, Inc. Chart of Accounts							
Leased Equipment	Acc. Dep., Leased	Accounts Payable	Interest Payable	Note Payable	Lease Payable	Common Stock	Retained Earnings
						$160,000	
				$400,000			
		$239,800					
		($213,360)					
				($20,000)			
			$6,650				
$92,000	$11,500				$83,360		
$92,000	$11,500	$26,440	$6,650	$380,000	$83,360	$160,000	$0

Eads Heaters, Inc. Chart of Accounts								
Dividends	Sales	Cost of Goods Sold	Bad Debt Exp.	Dep. Exp.	Int. Exp.	Other Oper. Exp.	Rent Exp.	Prov. Income Taxes
	$398,500							
					$21,000			
						$34,200		
$23,200								
					$6,650			
			$4,970					
		$188,800						
				$30,000				
				$11,500	$7,360			
								$23,505
$23,200	$398,500	$188,800	$4,970	$41,500	$35,010	$34,200	$0	$23,505

ii. Trial Balance

Eads Heaters, Inc. Trial Balance December 31, 20X1		
Asset Accounts		
Cash	$7,835	
Accounts Receivable	99,400	
Allowance for Bad Debts		$4,970
Inventory	51,000	
Land	70,000	
Building	350,000	
Accumulated Depreciation, Building		10,000
Equipment	80,000	
Accumulated Depreciation, Equipment		20,000
Leased Equipment	92,000	
Accumulated Depreciation, Leased Equipment		11,500
Liability Accounts		
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		83,360
Equity Accounts		
Common Stock		160,000
Retained Earnings		
Dividends	23,200	
Sales		398,500
Cost of Goods Sold	188,800	
Bad Debt Expense	4,970	
Depreciation Expense	41,500	
Interest Expense	35,010	
Other Operating Expenses	34,200	
Rent Expense		
Provision for Income Taxes	23,505	
TOTALS:	$1,101,420	$1,101,420

Case Study 2
Totz and Doodlez:

Financial Guidance for Totz and Doodlez on Income Statement Items using the FASB Codification

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    c. Gain on Sale of Corporate Headquarters pg. 19

    d. Class Action Settlement pg. 20

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1. Introduction

Totz is a high-end children's clothing manufacturer that sells its apparel through various store fronts. In the third quarter of the 2015 fiscal year, Totz opened an in-store art studio, Doodlez, that offers painting, pottery, and drawing classes. The following financial information provides guidance on the income statement presentation for Totz using the Financial Accounting Standards Board (FASB) Codification, which is the source of authoritative Generally Accepted Accounting Principles (GAAP) that applies to nongovernmental entities. Below, there are recommendations on how to approach four different income statement items: net sales, gross profit, gain on sale of corporate headquarters, and gain from class action settlement.

2. Totz and Doodlez

a. Net Sales

For fiscal year 2015, net sales should be recorded as $74.5 million without distinguishing between allocated sales for Totz and sales for Doodlez. According to ASC 225-10-S99-2b of the FASB Codification, a company can report income from multiple areas under the same heading if no one part exceeds 10 percent of the sum of the items.[1] So, for FY2015, Totz will report $74.5 million under "Net Sales" because Doodlez only makes up 5.2% of net sales. In FY2016, however, Doodlez makes up 12.9% of net sales, so Totz will report net sales with provisions to Totz and Doodlez. Reg S-X, Rule 5-03(b) states, "… each class which is not more than 10 percent of the sum of the items may be combined with another class." It also goes on to say that revenues from services should be stated separately. Since service revenue attributable to Doodlez was greater than 10 percent of total revenues (it was nearly 13 percent in FY2016), sales for products (Totz) and services (Doodlez) should be presented on separate line items on the face of the income statement for all periods presented. As components of net sales, Totz will allocate its income excluding Doodlez as $75.3 million under "Sale of Tangible Products" and the net sales derived from Doodlez will be reported as $11.2 million under "Service Revenue." According to Section 210.4-08(k) of the Sarbanes-Oxley Act, the increase in net sales of $4.7 million that resulted from an increase in the average transaction value must be reported as a note on the income statement.[2]

---

[1] See appendix for ASC 225-10-S99-2b

[2] See appendix for S-X 210.4-08(k)

b. Gross Profit

Regarding the cost of sales excluded depreciation, ASC 225-10-S99-8 requires that depreciated be included in calculating gross profit on the income statement. As such, Totz should not report a gross profit subtotal because the excluded depreciation is attributable to cost of sales.[3] Also, to provide clarity on the rise of cost of sales between FY2015 and FY2016, a note should be included on the income statement specifying that the $9.6 million increase is primarily due to the cost of Doodlez's services. So, Totz should include depreciation in the determination of gross profit and make a note that Doodlez is the main cause of the $9.6 million increase in cost of sales.

c. Gain on Sale of Corporate Headquarters

The gain realized by Totz for its abandoned building in 2015 is classified as an extraordinary item in compliance with ASC 605-10-S99-1[4], which states that gains or losses from the sale of assets should be reported as 'other general expenses'…Any material item should be stated separately. So, it should be classified under the "Income from Continued Operations" section on the income statement based on ASC 360-10-45-5[5]. So, for FY2015 Totz should report a $1.7 gain on sale under "Income from Continuing Operations."

[3] See appendix for ASC 225-10-S99-8
[4] See appendix for ASC 605-10-S99-1
[5] See appendix for ASC 360-10-45-5

d. Class Action Settlement

According to the facts presented, the costs associated with the natural fiber materials provided by the supplier are part of Totz' central operations; therefore, the gain recognized in connection with the class action settlement should be presented within operating income. Any material item should be stated separately. ASC 605-10-S99-1 indicates that the SEC believes the guidance in Reg S-X, Rule 5-03(b) applies to both gains and losses (i.e., not just expenses or losses).[6]

[6] See appendix for Reg S-X, Rule 5-03(b)

3. Appendix

1. ASC 225-10-S99-2

Costs and expenses applicable to sales and revenues.

State separately the amount of

(a) cost of tangible goods sold,

(b) operating expenses of public utilities or others,

(c) expenses applicable to rental income,

(d) cost of services, and

(e) expenses applicable to other revenues.

2. Section 210.4-08(k) of Regulation S-X

Related party transactions should be identified, and the amounts stated on the face of the balance sheet, income statement, or statement of cash flows.

3. ASC 225-10-S99-8

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

4. ASC 605-10-S99-1

Gains or losses from the sale of assets should be reported as 'other general expenses' … Any material item should be stated separately."

5. ASC 360-10-45-5

A gain or loss recognized on the sale of the long-lived asset (disposal group) that is not a component of an entity shall be included in income from continuing operations before income taxes in the income statement of a business entity

6. Reg S-X, Rule 5-03(b)

If income is derived from more than one of the subcaptions described under § 210.5-03.1, each class which is not more than 10 percent of the sum of the items may be combined with another class. If these items are combined, related costs and expenses as described under § 210.5-03.2 shall be combined in the same manner.

Case Study 3
Rocky Mountain Chocolate Factory:

Financial Analysis of Balance Sheet Accounts for Rocky Mountain Chocolate Factory

The Rocky Mountain Chocolate Factory case centers around a fictitious company used to explore the accounting cycle and financial statement preparation for a small business. The case involved recording several economic events as journal entry transactions, recording adjustments, preparing a pre-closing trial balance, record closing entries, prepare a post-closing trial balance, and then create a full set of financial statements based on that balance. This exercise provided a meaningful perspective of the accounting cycle and preparation of statements without the full scope and size involved of a real company.

	Beginning Balance February 28, 2009	1. Purchase Inventory	2. Incur Factory Wages	3. Sell inventory for Cash and on Account	4. Pay for Inventory	5. Collect Receivables
Cash and Cash Equivalents	1,253,947			17,000,000	(8,200,000)	4,100,000
Accounts Receivable	4,229,733			5,000,000		(4,100,000)
Notes Receivable, Current	0					
Inventories	4,064,611	7,500,000	6,000,000	(14,000,000)		
Deferred Income Taxes	369,197					
Other	224,378					
Property and Equiment, Net	5,253,598					
Notes Receivalbe, less current portion	124,452					
Goodwill, net	1,046,944					
Intangible Assets, net	183,135					
Other	91,057					
Accounts Payable	1,074,643	7,500,000			(8,200,000)	
Accrued Salaries and Wages	423,789		6,000,000			
Other Accrued Expenses	531,941					
Dividends Payable	598,986					
Deferred Income	142,000					
Deferred Income Taxes	827,700					
Common Stock	179,696					
Additional Paid-In Capital	7,311,280					
Retained Earnings	5,751,017					
Sales	0			22,000,000		
Franchise and Royalties Fees	0					
Cost of Sales	0			14,000,000		
Franchise Costs	0					
Sales and Marketing	0					
General and Administrative	0					
Retail Operating	0					
Depreciation and Amortization	0					
Interest Income	0					
Income Tax Expense	0					
A = L + OE + R - E		operating	operating	operating	operating	operating

	6. Incur SG&A (Cash and Payables)	7. Pay Wages	8. Receive Franchise Fee	9. Purchase PPE	10. Dividends declared and paid	11. All other transactions	Unadjusted Trial Balance
Cash and Cash Equivalents	(2,000,000)	(6,423,789)	125,000	(498,832)	(2,403,458)	790,224	(10,410,855)
Accounts Receivable						(702,207)	(702,207)
Notes Receivable, Current						91,059	91,059
Inventories						(66,328)	(66,328)
Deferred Income Taxes						92,052	92,052
Other						(4,215)	(4,215)
Property and Equiment, Net				498,832		132,859	631,691
Notes Receivalbe, less current portion						139,198	139,198
Goodwill, net							0
Intangible Assets, net						(73,110)	(73,110)
Other						(3,007)	(3,007)
Accounts Payable						503,189	503,189
Accrued Salaries and Wages		(6,423,789)					(6,423,789)
Other Accrued Expenses	3,300,000					(2,885,413)	414,587
Dividends Payable					3,709	(1)	3,708
Deferred Income			125,000			(46,062)	78,938
Deferred Income Taxes						66,729	66,729
Common Stock						1,112	1,112
Additional Paid-In Capital						315,322	315,322
Retained Earnings					(2,407,167)		(2,407,167)
Sales						944,017	944,017
Franchise and Royalties Fees						5,492,531	5,492,531
Cost of Sales						693,786	693,786
Franchise Costs						1,499,477	1,499,477
Sales and Marketing	1,505,431						1,505,431
General and Administrative	2,044,569					(261,622)	1,782,947
Retail Operating	1,750,000						1,750,000
Depreciation and Amortization							0
Interest Income						(27,210)	(27,210)
Income Tax Expense						2,090,468	2,090,468
A = L + OE + R - E	operating	operating	operating	investing	financing		

	12. Adjust for Inventory Count	13. Record Depreciation	14. Wage Accrrual	15. Consultant's Report	Pre-Closing Trial Balance	16. Closing Entry	Post-Closing Balance	Actual February 28, 2010 F/S Figures
Cash and Cash Equivalents					0		0	3,743,092
Accounts Receivable					0		0	4,427,526
Notes Receivable, Current					0		0	91,059
Inventories	(216,836)				(216,836)		(216,836)	3,281,447
Deferred Income Taxes					0		0	461,249
Other					0		0	220,163
Property and Equiment, Net		(698,580)			(698,580)		(698,580)	5,186,709
Notes Receivalbe, less current portion					0		0	263,650
Goodwill, net					0		0	1,046,944
Intangible Assets, net					0		0	110,025
Other					0		0	88,050
Accounts Payable					0		0	877,832
Accrued Salaries and Wages			646,156		646,156		646,156	646,156
Other Accrued Expenses					0		0	946,528
Dividends Payable					0		0	602,694
Deferred Income					0		0	220,938
Deferred Income Taxes					0		0	894,429
Common Stock					0		0	180,808
Additional Paid-In Capital					0		0	7,626,602
Retained Earnings					0	(1,561,572)	(1,561,572)	6,923,927
Sales					0	(22,944,017)	(22,944,017)	22,944,017
Franchise and Royalties Fees					0	(5,492,531)	(5,492,531)	5,492,531
Cost of Sales	216,836				216,836	(14,910,622)	(14,693,786)	14,910,622
Franchise Costs					0	(1,499,477)	(1,499,477)	1,499,477
Sales and Marketing					0	(1,505,431)	(1,505,431)	1,505,431
General and Administrative			639,200		639,200	(2,422,147)	(1,782,947)	2,422,147
Retail Operating			6,956		6,956	(1,756,956)	(1,750,000)	1,756,956
Depreciation and Amortization		698,580			698,580	(698,580)	0	698,580
Interest Income					0	27,210	27,210	(27,210)
Income Tax Expense					0	(2,090,468)	(2,090,468)	2,090,468
A = L + OE + R - E							0	

Rocky Mountain Chocolate Factory Income Statement For Year Ended February 28, 2010		
Revenues		
Sales		$22,944,017
Franchise and Royalty Fees		5,492,531
Total Revenues		28,436,548
Costs and Expense		
Cost of Sales, exclusive of depreciationand amortization expenseof $336.009. $370.485. and $389.273		14,910,622
Franchise Costs		1,499,477
Sales & Marketing		1,505,431
General & Administrative		2,422,147
Retail Operating		1,756,956
Depreciation and Amortization		698,580
Total Costs and Expenses		22,793,213
Operating Income		5,643,335
Other Income (Expense)		
Interest Expense		0
Interest Income		27,210
Other, net		27,210
Income Before Income Taxes		5,670,545
Income Tax Expense		2,090,468
Net Income		$3,580,077
Basic Earnings per Common Share		$0.60
Diluted Earnings per Common Share		$0.58
Weighted Average Common Shares Outstanding		6,012,717
Dilutive Effect of Employee Stock Options		197,521
Weighted Average Common Shares Outstanding, Assuming Dilution		6,210,238
All figures are in thousands of dollars		

Rocky Mountain Chocolate Factory Balance Sheet February 28, 2010		
Assets		
Current Assets		
Cash and Cash Equivalents	$3,743,092	
Accounts Receivable, less allowance for doubtful accounts of $395,291 and $332,719, respecitvely	4,427,526	
Notes Receivable, current	91,059	
Inventories, less reserve for slow moving inventory of $263,872 and $251,922, respectively	3,281,447	
Deferred Income Taxes	461,249	
Other	220,163	
Total Current Assets		$12,224,536
Property and Equipment, net		5,186,709
Other Assets		
Notes Receivable, less current portion	263,650	
Goodwill, net	1,046,944	
Intangible assets, net	110,025	
Other	88,050	
Total other assets		1,508,669
Total Assets		$18,919,914
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	$877,832	
Accrued Salaries and Wages	646,156	
Other Accrued Expenses	946,528	
Dividends Payable	602,694	
Deferred Income	220,938	
Total current liabilities		$3,294,148
Deferred Income Taxes		894,429
Commitments and Contingencies		
Stockholders' Equity		
Preferred Stock, $0.10 par value, authorized 250,000 shares; 0 shares issued and outstanding	0	
Series A Junior Participating Preferred Stock authorized 50,000 shares	0	
Undesignated Series, authorized 200,000	0	
Common Stock, $0.03 par value; 100,000,000 shares authorized; 6,026,938 and 5,989,858 shares issued and	180,808	
Additional Paid-In Capital	7,626,602	
Retained Earnings	6,923,927	
Total Stockholders' Equity		14,731,337
Total Liabilities and Equity		$18,919,914
All figures are in thousands of dollars		

Case Study 4
Internal Controls:

Financial Risk Assessment Regarding Internal Controls

This case study involved evaluating and reporting on the internal controls of a fictitious company with relatively few employees in addition to the store owner. Several potential fraud schemes were developed in order to establish a discussion frame for improving the internal controls of the company, and then based on each of those fraud schemes, the group discussed potential control solutions.

Potential Fraud Scheme	Internal Control
Lucy is responsible for recording sales and preparing bank deposits. Given her autonomy with this process, Lucy could be underreporting sales and failing to deposit all of the money.	In order to comply with separation of duties, one employee should be responsible for recording sales and another should be responsible for depositing money for those sales. This separation of responsibility makes it harder for one person to commit this type of fraud.
The store that Kayla owns may have a petty cash fund that was established for smaller and miscellaneous expenses. If they do have a petty cash fund, employees may be incorrectly being reimbursed from the fund.	In order to prevent this and ensure that petty cash fund disbursements are accurate, there should be access controls. Kayla should be the custodian. This means that she is the only person that can make payments. Also, Kayla, serving as the custodian, will need to collect receipts as a way of proving accurate disbursement.
Kayla's store just implemented a new coupon discount program. Employees could be scanning coupons but charging the customers full price and then pocketing the difference.	With this new program, there is limited evidence of processing the transaction. Clerks should have to enter all amounts into the system and keep the coupon with the receipt of the transaction.
There is no evidence of a system to track the hours that each employee works.	Kayla should implement a time card system to track exactly when each employee works.
Kayla is responsible for the oversight of inventory, orders for new inventory, and payments of inventory. She could commit an act of fraud by falsifying orders, paying them to an external account, and expensing more inventory than actual to make up for the difference. This would reduce the income tax expense of the business by underreporting income while funneling cash out of the business.	A separate employee should be responsible for inventory orders and payment of inventory orders. This separation of responsibility would prevent one person from autonomously falsifying orders to be paid to external accounts.

Potential Fraud Scheme	Internal Control
There is only one credit card machine for both cash registers.	There is no way of knowing which employee is responsible for the credit card sale. There should be a credit card machine for each register so that credit card transactions can be allocated to the correct employee.
There is no mention of a security system.	If a security system was put in place, complete with cameras, then employees would be monitored at all times.
Each employee has full authority to enter each type of transaction, meaning that they could change previous transactions.	Kaya, as the owner, should be the only person with full authority. All other employees should have limited authority that allows them to only record transactions that are directly related to the sales process.
Kayla has full custody of assets, and she also does the record keeping.	Kayla should not be handling so much responsibility within the business since she is the owner of the company. Someone else should be helping with or taking over this area.
Kayla and Lucy both have access to the accounting system, with Kayla handling all accounting functions and Lucy recording sales data and preparing bank deposits.	This is an issue because Lucy and Kayla can both access records, which could lead to small changes to the sales records by Lucy without Kayla realizing it. Thought separation of duties is important, it is also important for the information to be valid and consistent.

Case Study 5: Manufacturing

A Financial Analysis of the Inventory Cycle and Cost Accounting

This case delves into the realm of cost accounting by following the inventory system from raw materials to works in process to finished goods. Additional topics covered in the case were obsolescence and unmarketable inventory, cost of sales, inventory turnover, and inventory holding. The case allowed the opportunity to explore a more analytical approach to cost accounting. In addition to just recording the inventory transactions and understanding the accounting behind them, the case involved analyzing the attributes associated with the company's inventory system in order to gain perspective on the company as a potential investor.

1. **Inventory**
    a. In raw materials inventory, the costs incurred will be related to direct materials and indirect materials.
    b. For work-in-process inventory, direct labor and factory overhead will be the primary costs.
    c. Finished Goods Inventory will include carrying costs, direct materials, direct labor, and factory overhead.
2. **Here, inventories are recorded net of allowance for obsolete or unmarketable inventory.**
3. **Related to Note 2: Allowance for Obsolete and Unmarketable Inventory**
    a. This account will appear in the current assets section on the company's balance sheet. It will be listed under inventory as a contra inventory account to give net inventory. This is much like the presentation of allowance for doubtful accounts with accounts receivable to yield net inventory.

b. The gross amount of inventory at the end of 2011 is $243,870.

The gross amount of inventory at the end of 2012 is $224,254.

c. The portion of the reserves for obsolete inventory is most attributable to finished goods inventory. It is semi attributable to work-in-process inventory, and it is least attributable to raw materials inventory.

4. **To set up Cost of Sales account**:

	Debit	Credit
Cost of Sales	13,348	
allowance for obsolete or unmarketable inventory		13,348

To write off inventory:

	Debit	Credit
allowance for obsolete or unmarketable inventory	11,628	
Finished Goods Inventory		11,628

5. **Inventory Accounts, Accounts Payable, and Cost of Sales**

RM Inventory		Work-in-Process Inventory		Finished Goods Inventory	
46,976	442,068	1,286	568,735	184,808	13,348
438,561		126,000		568,735	572,549
		442,068			
43,469		619		167,646	

Cost of Sales		Accounts Payable	
0		432,197	39,012
572,549			438,561
13,348			
585,897			45,376

a. Cost of Goods Sold: $572,549

b. Cost of Goods Manufactured: $568,735

c. Cost of RM transferred to WIP: $442,068

d. Cost of Raw Materials Purchased: $438,561

e. Cash Disbursed for Raw Material Purchases: $20,216

6. $\textbf{Inventory Turnover Ratio} = \frac{\text{Cost of Sales}}{\text{Average inventories,net}} = \frac{\$585{,}897}{\$222{,}402} = 2.63$ FY 2012

   $\textbf{Inventory Turnover Ratio} = \frac{\text{Cost of Sales}}{\text{Average inventories,net}} = \frac{\$575{,}226}{\$250{,}830} = 2.29$ FY 2011

7. $\textbf{Inventory Holding Period} = \frac{365}{\text{Inventory Turnover Ratio}} = \frac{365}{2.63} = 138.8$ FY 2012

   $\textbf{Inventory Holding Period} = \frac{365}{\text{Inventory Turnover Ratio}} = \frac{365}{2.29} = 159.4$ FY 2011

8. $\textbf{Percent of Inventory, Obsolete} = \frac{\text{Obsolete Inventory}}{\text{Finished Goods Inventory}} = \frac{\$13{,}348}{\$180{,}812} = 7.4\%$

In addition to the information given, as a potential investor, I would like to have a better grasp of the company's liquidity and efficiency, solvency, and financial flexibility. Knowing the liquidity and efficiency allows for better understanding of the amount of time the company takes to convert an asset into cash and how easily an asset is converted into cash. Ratios like current ratio, days' sales in inventory, and total asset turnover lend achieve this goal. Defining the company's solvency helps in gauging the company's ability to pay debts as they come due. Calculating the debt ratio, equity ratio, debt to equity ratio, and times interest earned ratio allows me to know the debt position of the company. Outlining the company's financial flexibility plays an important role in determining the ability of a company to weather unexpected financial crisis and take advantage of unexpected investment opportunities. Reviewing the financials through this lens will provide for a complete look into the prospects of investing into this company.

Case Study 6: WorldCom, Inc.

A financial Analysis for WorldCom, Inc. focusing on the improper treatment of expense

The WorldCom case explores the accounting surrounding the misstatements that led to the demise of WorldCom. This case was a critical factor in the dissolution of Arthur Anderson, the largest CPA firm in the world at the time, and was one of a number of significant accounting scandals that came to light in the early 2000's.

a. FASB Statement of Concept No. 6

i. **Assets** are future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. Acquired through means of cash, loans, or transfer of other assets, these economic benefits are obtained for the purpose of generating future revenues.

   Expenses are outflows or other using up of assets or incurrences of liabilities, or a combination of both from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations. Expenses are incurred in the process of generating revenues, prices paid to profit as a company.

ii. In general, costs should be expenses when revenues are recognized, which follows the matching principle. Costs should only be capitalized when they are associated with assets that will produce future revenues.

b. Describe how asset capitalization affects expensing

After their initial capitalization, costs are depreciated over a number of periods instead of being expensed at one time. The total cost is divided over a number of years and allocated accordingly.

c. Line Costs for 2001

	Debit	Credit
Line Costs	$14,739,000,000	
Cash		$14,739,000,000

d. Detail the impropriety regarding line costs

Line costs were improperly capitalized at WorldCom, occurring out of charges paid to local telephone networks to complete calls. These costs do not fall under the umbrella of assets because they are incurred in the profit-making function of the company.

e. Entry to improperly capitalize line costs

	Debit	Credit
PPE	$3,055,000,000	
Line Costs		$3,055,000,000

f. Depreciation calculated using Straight Line over 22 years

Quarter	Costs Improperly Capitalized	Annual Depreciation Expense
Q1	$771,000,000	$35,045,455
Q2	$610,000,000	$20,795,455
Q3	$743,000,000	$16,886,364
Q4	$931,000,000	$10,579,545
Total		$83,306,818

	Debit	Credit
Depreciation Expense	$83,306,818	
Accumulated Depreciation		$83,306,818

g. Portion of income statement showing effect of improper capitalization

Income before Taxes, as reported	$2,393,000,000.00
Depreciation Expense	83,306,818.00
Line costs improperly capitalized	-3,055,000,000.00
Loss before taxes, restated	-578,693,182.00
Income tax benefit	202,542,613.70
Minority Interest	35,000,000.00
Net Loss, Restated	-$341,150,568.30

Yes, this is material given the drastic change that occurs with the restatement.

Case Study 7:
Targa Company

A Financial Analysis for Targa Company through research methods and the FASB Codification

Introduction

Targa Company has recently decided to discontinue the research and development line of Armor Track due to the change in the company's priorities and the competition in the marketplace. The company will pay an estimated $2.5 billion in benefits and $500,000 in severance packages to the terminated employees. The facility manager will also receive an additional $50,000 when the facility is officially closed. Relocation and training costs for Targa amount to $500,000 and $1.5 million, respectively. The following information serves to assist Targa in accounting for these events in the year-end financial statements.

Employee Benefits

Per the FASB Codification, Section 712-25-10-2, "An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments." Section 420-10-30-6 adds further clarity on the timing of recognition for the liability, specifically in cases where employees are required to render services. It states, "If employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, a liability for the termination benefits shall be measured initially at the communication date based on the fair value of the liability as of the termination date.

Retraining and Relocation Costs

Considering the relocation cost, Targa should also recognize it as a liability according to the Exit and Disposal Cost Obligations section of the FASB Codification. Here, the codification presents the requirements for exit costs to be treated as a liability. 420-10-15-4 states that an exit activity includes but is not limited to a restructuring, such as the sale or termination of a line of business, the closure of business activities in a particular location, the relocation of business activities from one location to another, changes in management structure, and a fundamental reorganization that affects the nature and focus of operations. Though not specifically referenced in the Codification, retraining costs would be considered as associated costs with the disposal activity and recorded as a liability per section 420-10-25-15, which reads "The liability shall not be recognized before it is incurred, even if the costs are incremental to other operating costs and will be incurred as a direct result of a plan. A liability for other costs associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred (generally, when goods or services associated with the activity are received)."

Summary

In short, the $2.5 million termination benefits, $500,000 severance package, and $50,000 lump-sum benefit to the facility manager, and the $500,000 relocation cost should be recognized as liabilities on the year-end financial statements. The $1.5 million staff training cost should be reported as a liability when incurred, so this amount should not be disclosed on the year-end financial statements.

Case Study 8:
Merck & Co., Inc.

A Financial Analysis of Merck. & Co., Inc. for Shareholders' Equity

This case analyzes equity in financial reporting following the operations of Merck Co. The case involves distinguishing between shares authorized, shares outstanding, stock price, and operations to calculate total market capitalization of Merck Co. Further, the case extends into a discussion of why companies pay dividends on common shares and the impact of that decision on stock price. Finally, the case explores the concept of treasury stock and its impact on financial reporting.

a. Consider Merck's common shares.

i. Merck is authorized to issue 5,400 million common shares.

ii. Merck has issued 2,984 million common shares at December 31, 2007

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

2,983,508,675 x $0.01 = $29,835,086,750

iv. Merck is holding 811 million common shares in the treasury at December 31, 2007.

v. Merck has 2,173 million common shares outstanding at December 31, 2007.

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.

2,983,508,675 x $57.61 = $171,879,934,766.75

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

Companies pay dividends on their common shares to show their financial health by their ability to spare the cash to distribute to shareholders. On the other hand, companies that are paying dividends instead of reinvesting that money into other companies could be indicating that the company has extinguished its investment opportunities. After dividends are paid, a company's share price falls due to part of that amount being paid to shareholders through the dividends.

d. Companies repurchase their own stock:

i. due to the stock being undervalued, meaning the company can repurchase low and resell high
ii. to increase earnings per share
iii. to privatize in order to prevent possible takeover attempts or to limit outside control
iv. to provide stock for employee stock compensation plans
v. to make a market in the stock by creating an artificial type demand
vi. to provide a tax efficient distribution to shareholders

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.

Account	Debit	Credit
Retained Earnings	3,310,700,000	
Dividends Payable		3,400,000
Cash		3,307,300,000

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

i. Merck uses the cost method to account for its treasury stock transactions. Using this method, treasury stock is debited at cost, and all entries to the treasury stock account are made at the original repurchase cost. Treasury stock does not affect capital stock or add. paid-in capital and is subtracted at the bottom of the stockholders' equity section on the balance sheet.

ii. Merck repurchase 26.5 million shares on the open market during 2007.

iii. Merck paid $1.4297 billion in total and $53.95 per share, on average. to buy back its stock during 2007. This would be considered a financing activity.

iv. Merck doesn't disclose its treasury stock as an asset because treasury stock is a contra-equity account.

i. Ratio Analysis for Merck & Co., Inc.

(in millions)	**2007**	**2006**
Dividends Paid	$3,307	$3,323
Shares Outstanding	2,173	2,168
Net Income	$3,275	$4,434
Total Assets	$48,351	$44,570
Operating Cash Flows	$6,999	$6,765
Year-End Stock Price	$57.61	$41.94
Dividends per Share	$1.52	$1.53

Dividend Yield	2.6%	3.6%
Dividend Payout	101%	74.9%
Dividends to Total Assets	6.8%	7.5%
Dividends to Operating Cash Flows	47.3%	49.1%

Case Study 9:
Xilinx, Inc.

A Financial Analysis of Xilinx, Inc. for Stock-based Compensation

The Xilinx, Inc. case continues the discussion of equity and addresses stock options and restricted stock of the company. The case explores how stock options and stock compensation are implemented in a company, the concept of restricted stock and how it is used, and the impact of both on a company's financial reporting and disclosures.

a. **Stock option plans are designed to align incentives between the owners and the managers. Because the stock price increases with earnings per share, this essentially gives executives incentive to increase stock price. Stock option plans, in this case, encourage employees to raise the earnings per share because they directly benefit based off their performance.**

   Xilinx's employee stock option plan is structured as follows:

   i. 28.7 million shares as of March 30, 2013, are reserved for future issuance to employees and directors as common shares, with 16 million of those shares available for future grants under the 2007 Equity Plan.
   ii. Shares are granted at 100% of the fair market value of the stock on the date of the grant.
   iii. The vesting period for stock awards granted under the 2007 Equity Plan is seven years.
   iv. The vesting period for stock awards granted to existing and newly hired employees is four years.
   v. Stock options granted prior to April 1, 2007, generally expire 10 years from the grant date.

b. Compare the use of Restricted Stock Units and stock options as a form of incentive compensation to employees. Why might companies offer both types of programs to employees?

RSUs never become completely worthless whereas stock options can become worthless if the stock price is below or equal to the grant price. Restricted Stock Units also result in less dilution to existing stockholders. Lastly, Restricted Stock Units better align employee incentives with the company's incentives by providing more of a long-term perspective compared to stock options which offer more of a short-term perspective. Companies might offer both types of programs to appeal to employees based on their time vested in the company, appeal of cash versus stock, and willingness to take risks.

c. Explain the following terms:

grant date - the date on which an option or other award is granted

exercise price - the price at which the security underlying an options contract may be bought or sold

vesting period - the period between the grant date and the date the stock option can be exercised or the RSU becomes stock

expiration date - the date at which the stock option expires

options/RSUs granted - the stock option or RSU granted as compensation

options exercised - the options that have been utilized, or put into action

options/RSUs forfeited or cancelled - the options unable to be used due to departure from the company before vesting

d. Xilinx's employee stock purchase plan is structured as follows:

i. Xilinx has 8.9 million shares available for future issuance, with 48.5 million shares authorized.

ii. Employees can obtain a 24-month purchase right to purchase stock at the end of each 6-month exercise period.

iii. Employees may only participate up to 15% of their earnings or a $21,000 a calendar year.

iv. Xilinx sets the purchase price at 85% of the lower of fair market value at the beginning of the 24-month period or at the end of each six-month exercise period.

Employees can purchase stock at a fraction of the fair market value, compared to the stock option plan and the RSU plan that essentially grant stock options and stock to employees. The biggest incentives revolve around the ability to purchase the stock now versus having to go through a vesting period required in the stock option plan and the RSU plan.

e. Treatment of Compensation Expense

The company must record the cost of compensation expense over the period during which the employee is required to perform service in exchange for the award based on the cost of all employee equity awards expected. The company also records compensation expense for the unvested portion of granted awards that are still outstanding at the date of adoption. Cash flows form excess tax benefits should be classified under the financing activities section on the

Statement of Cash Flows. Xilinx must record their stock purchase plan under the same guidance. The Company uses the straight-line attribution method to recognize stock-based compensation costs over the requisite service period of the award. Upon exercise, cancellation, or expiration of stock options, DTAs for options with multiple vesting dates are eliminated for each vesting period on a first-in, first-out basis as if each award had a separate vesting period. To calculate the excess tax benefits available for use in offsetting future tax shortfalls as of the date of implementation, the Company followed the alternative transition method.

f. Stock-based Compensation-Statement of Cash Flows and Income Statement

i. Xilinx reports $77,862 for stock-based compensation in 2013.

ii. Xilinx allocates the compensation expense on the income statement between CGS, R&D expense, and SGA expense. These are the accounts that relate to the overall stock-based compensation based on the services provided by the professionals that relate to each area of the company.

iii. The compensation expense is recorded as an increase under the Operating Activities section of the Statement of Cash Flows.

iv. Because Xilinx was unable to deduct the stock options on the 2013 income statement, the income tax effect is $22,137.

v.

Cost of Goods Sold	6,356	
R & D Expense	37,937	
S & G & A Expense	33,569	
Add. PIC- Stock Options		77,862

i. "Last Gasp for Stock Options" from the *Wall Street Journal*

i. The article expresses that stock options are declining, and restricted stock plans are increasing. Companies find restricted stock plans more attractive than stock options, since restricted stock plans offer a simple form of compensation, dilute earnings per share less, and encourage employees to stay with the company more given that restricted stock plans have more value from the start. Employees also prefer restricted stock plans. They are enticing because of the higher immediate value, lower risk, and fewer complexities.

ii. Referring to the tables in the footnotes, yes, Xilinx's footnotes display evidence consistent with the trends in the article stating that stock options are declining, and restricted stock plans are increasing. On page 62, the table detailing the stock options shows a declining number of stock options outstanding each year from 2010 to 2013. On page 63, the table listing the restricted stock plans illustrates an increasing number of restricted stock plans each year from 2010 to 2013.

Case Study 10:
Bier Haus

A Financial Analysis of Various Situations
involving College Students on Campus

Part I:

Background:

Week 1: a college student walks into the Bier Haus on campus and orders a large plastic cup of beer. The bartender takes the order and says it will cost $5. The student hands the bartender $5. The bartender then pours the beer into a large cup and hands it to the student. The student rushes off to ACCY 304.

Requirements:

1. Read ASC 606-10-05-04, 606-10-25-1 and 606-10-25-30.
2. How does each step in the five-step revenue model apply to this transaction?
    a. **Step 1**: Identify the contract(s) with a customer: The bartender enters into a contract with the student when the customer orders a beer and the bartender says it will cost $5.
    b. **Step 2**: Identify the performance obligations in the contract: The performance obligation in the contract is for the bartender to give the student a beer.
    c. **Step 3**: Determine the contract price: The contract price is $5
    d. **Step 4**: Allocate the transaction price to the performance obligations: There is only one performance obligation, so the $5 is allocated entirely to the beer.
    e. **Step 5**: Recognize revenue when (or as) the entity performs the obligation: Recognize revenue immediately, as the performance obligation is satisfied immediately.
3. Prepare the journal entry to record the transaction.

Account	Debit	Credit
Cash	$5	
Beer Revenue		$5

Part II:

Background:

Week 2: the same student goes into the Bier Haus and orders a large beer in an Ole Miss thermal beer mug as part of a "drink on campus" campaign. The student plans to use this mug daily for refills rather than using plastic cups. The bartender pours the beer into the mug and delivers it to the student. The bartender then collects $7 from the student. Standalone selling prices are $5 for the beer and $3 for the mug, so the student got a bargain on the combined purchase. The student takes the beer in the new mug and enjoys it while reading the codification.

Requirements:

1. Read ASC 606-10-25-19 to 22 and 606-10-32-31 to 32.
2. How does each step in the five-step revenue model apply to this transaction?
    a. **Step 1**: Identify the contract(s) with a customer: The bartender enters into a contract with the student when the customer orders a beer in a thermal beer mug and the bartender says it will cost $7.
    b. **Step 2**: Identify the performance obligations in the contract: The performance obligation in the contract is for the bartender to give the student a beer in a mug.
    c. **Step 3**: Determine the contract price: The contract price is $7.
    d. **Step 4**: Allocate the transaction price to the performance obligations: Because the standalone prices for each item is more than the combined price, allocate the cost of each item based on the percent of the total purchase price.
    e. **Step 5**: Recognize revenue when (or as) the entity performs the obligation: Recognize revenue instantly; that is when the performance obligation is satisfied.

3. Prepare the journal entry to record the transaction.

Account	Debit	Credit
Cash	$7	
Beer Revenue		$4.40
Mug Revenue		$2.60

Part III:

Background:

Week 3: the same student goes into the Bier Haus bringing in his beer mug and orders a large beer and a pretzel. Standalone selling prices are $5 for the beer and $2 for the pretzel. The bartender tells the student they are out of pretzels. The bartender then offers the student the large beer and a coupon for two pretzels (its typical business practice) for $7. The student pays the $7 to the bartender. The bartender gives the student a coupon for two pretzels. The bartender pours the beer into the beer mug and hands it to the student. The student then takes the beer and the coupon and heads to the dorm to study for the upcoming Intermediate accounting exam. The Bier Haus sells a coupon for two pretzels for $3.50. To increase visits, these coupons can be redeemed any date after the date of purchase. The Bier Haus has limited experience with these coupons but, so far, these coupons have always been redeemed.

Requirements:

1. Read ASC 606-10-25-2 to 6.
2. How does each step in the five-step revenue model apply to this transaction?
   a. Step 1: Identify the contract(s) with a customer: The bartender enters into a contract with the student when the customer orders a beer and two pretzels. The contract is modified when the bartender gives the student a coupon for two pretzels instead of two pretzels.
   b. Step 2: Identify the performance obligations in the contract: The performance obligations in the contract are for the bartender to give the student a beer now and two pretzels at a future date redeemable by a coupon.
   c. Step 3: Determine the contract price: The contract price is $7
   d. Step 4: Allocate the transaction price to the performance obligations: Allocate $5 to the beer and allocate $2.00 to the pretzels because that is the normal selling price of the coupon.
   e. Step 5: Recognize revenue when (or as) the entity performs the obligation: Recognize revenue for the beer immediately, but do not recognize revenue for the pretzels since the performance obligation has not been satisfied.
3. Prepare the journal entry to record the transaction.

Account	Debit	Credit
Cash	$7	
Beer Revenue		$5.00
Unearned Coupon Revenue		$2.00

Part IV:

Background:

Week 4: the same student goes into the Bier Haus and orders two pretzels. The bartender takes the order and asks for a $4 payment. The student hands the bartender the coupon. The bartender reviews the coupon, determines its validity, and accepts it as payment. The bartender gives the student the two pretzels. The student then heads off to share the pretzels with a classmate from ACCY 420.

Requirements:

1. How does each step in the five-step revenue model apply to this transaction?
    a. Step 1: Identify the contract(s) with a customer: The bartender enters into a contract with the student when the customer orders two pretzels for the coupon.
    b. Step 2: Identify the performance obligations in the contract: The performance obligation in the contract is for the bartender to give the student two pretzels.
    c. Step 3: Determine the contract price: The contract price is $2.00, which is the value of the coupon previously awarded to the student to redeem two pretzels.
    d. Step 4: Allocate the transaction price to the performance obligations: Since there is only one performance obligation, allocate the entire price to the two pretzels.
    e. Step 5: Recognize revenue when (or as) the entity performs the obligation: Recognize the revenue immediately as the performance obligation has been performed immediately.
2. Prepare the journal entry to record the transaction.

Account	Debit	Credit
Unearned Coupon Revenue	$2.00	
Pretzel Revenue		$2.00

Case Study 11: ZAGG Inc.

A Financial Analysis of ZAGG Inc. for Deferred Income Taxes

This case is an exploration into the financial reporting impact of deferred tax assets and deferred tax liabilities. The case uses Zagg, Inc. as a vehicle to explain, discuss, and analyze temporary tax differences and permanent tax differences in order to apply the proper accounting and financial reporting treatment.

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 synonymous with financial income, which is Revenue – Expenses = Net Income. For ZAGG, book income is $14,505,000. A company's book income differs from taxable income due to temporary differences, permanent differences, and loss carryforwards/carrybacks.

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

   i. **Permanent tax differences** - an amount that is presented differently depending on the reporting purpose, which can be financial or tax related and the difference will never be eliminated

      Example: municipal bond interest

   ii. **Temporary tax difference** - the difference between the carrying amount of an asset or liability in the balance sheet and its tax base, which can be deductible or taxable

      Example: depreciation, deferred tax asset or liability

   iii. **Statutory tax rate** - the tax rate imposed by law, expressed by a percent

   iv. **Effective tax rate** – the percent of income that is paid in taxes

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?**

A company would report deferred income taxes as part of their total income tax expense to faithfully represent their revenues & expenses. Companies report their deferred income taxes to match expenses to revenues per the matching principle.

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.**

Deferred income tax assets represent a positive cash flow, or an inflow, and are commonly shown by carry-over losses. Deferred income tax liabilities represent a negative cash flow, or an outflow, and are commonly represented by depreciation of fixed assets.

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

The deferred income tax valuation allowance is a provision relating to the deferred tax asset to ensure that the deferred tax asset is not overstated.

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 Tax Asset	$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.

Deferred Income Tax Asset	$8,002,000
Deferred Income Tax Liability	$ 291,000

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.

Effective Tax Rate = 39.3% (9,393/23,898)

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.

Current Deferred Tax Asset	6,912
Noncurrent Deferred Tax Asset	6,596

Case Study 12:
Build-A-Bear Workshop, Inc.

A Financial Analysis of Build-A-Bear Workshop, Inc. regarding Leases

This case delves into the realm of leasing with regard to accounting and financial reporting. Specifically, the case explores the difference between operating leases and capital leases and why a company may opt for one over the other. It provides analysis of the impact of each option based on financial ratios and offers a discussion of how debt-to-equity and debt-to-assets ratios are impacted.

a. Why do companies lease assets rather than buy them?

Companies lease assets because leases can be financed at fixed rates, offer protection against obsolescence, allow for flexibility, cost less, provide tax advantages, and permit off-balance-sheet financing.

b. Define the following terms:

i. **Operating Lease** - a contract that allows for the use of an asset but does not convey rights of ownership of the asset.

ii. **Capital Lease** - a contract entitling a renter to a temporary use of an asset, and such a lease has economic characteristics of asset ownership for accounting purposes. The capital lease requires a renter to add assets and liabilities associated with the lease if the rental contract meets specific requirements.

iii. **Direct-Financing Lease** - A lease arrangement between a non-manufacturer or non-dealer and a customer wherein the lessor acquires equipment for leasing it and generating revenue through interest payments.

iv. **Sales-Type Lease** - a type of capital lease where the present value of minimum lease payments i.e. the lease receivable for a lessor is higher than the carrying amount of the leased asset.

c. Why do accountants distinguish different types of leases?

Accountants distinguish between different types of leases because each is used for different purposes and results in differing treatment on the accounting books of a business.

d. Consider the following hypothetical lease for a Build-A-Bear retail location.

- The lease term is five years.
- Lease payments of $100,000 are due the last day of each year.
- At the end of the lease, title to the location does not transfer to Build-A-Bear nor is there a bargain purchase option.
- The expected useful life of the location is 25 years. The fair value of the location is estimated to be $1,500,000.

i. Will this lease be treated as an operating lease or a capital lease?

This lease will be treated as an operating lease because the lease will not transfer ownership, the lease does not contain a bargain-purchase option, the lease term is not greater than or equal to 75 percent of the estimated economic life of the leased property, and the present value of the minimum lease payments are not greater than or equal to 90 percent of the fair value of the leased property.

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

Account	Debit	Credit
Rent Expense	100,000	
Cash		100,000

iii. Assume that a second lease is identical to this lease except that Build-A-Bear Workshop is offered a "first year rent-free." That is, the company will make no cash payment at the end of year one but will make payments of $125,000 at the end of each of years 2 through 5. Provide the journal entries that the company will make over the term of this lease.

1	Rent Exp.	100000		**4**	Rent. Exp.	100000	
	Def. Rent		100000		Def. Rent	25000	
2	Rent Exp.	100000			Cash		125000
	Def. Rent	25000					
	Cash		125000	**5**	Rent Exp.	100000	
3	Rent Exp.	100000			Def. Rent	25000	
	Def. Rent	25000			Cash		125000
	Cash		100000				

e. Consider Build-A-Bear Workshop's operating lease payments and the information in Note 10, Commitments and Contingencies. Further information about their operating leases is reported in Note 1, Description of Business and Basis of Preparation (k) Deferred Rent.

i. What was the amount of rent expense on operating leases in fiscal 2009?

Rent expense was $45.9 million.

ii. Where did that expense appear on the company's income statement?

This expense appears under selling, general, and administrative expense.

f. Consider the future minimum lease payments made under the operating leases disclosed in Note 10, Commitments and Contingencies. Assume that all lease payments are made on the final day of each fiscal year. Also assume that payments made subsequent to 2014 are made evenly over three years.

i. Calculate the present value of the future minimum lease payments at January 2, 2010. Assume that the implicit interest rate in these leases is 7%.

	Lease Payments	Present Value Factor	Present Value of Lease Payments
1	50651	0.93458	47337
2	47107	0.87344	41145
3	42345	0.81630	34566
4	35469	0.76290	27059
5	31319	0.71299	22330
6	25229	0.66634	16811
7	25229	0.62275	15711
8	25229	0.58201	14683
Total			**219643**

ii. Had Build-A-Bear Workshop entered into these leases on January 2, 2010 (the final day of fiscal 2009), what journal entry would the company have recorded if the leases were considered capital leases?

	Debit	Credit
PPE	219,643	
Lease Obligation		219,643

iii. What journal entries would the company record in fiscal 2010 for these leases, if they were considered capital leases? There are two: one to record interest expense and the lease payment and one to record amortization of the leased asset.

Account	Debit	Credit
Lease Obligation	35,276	
Interest Expense	15,375	
Cash		50,651
Depreciation Expense	27,456	
Accum. Depreciation		27,456

g. Under current U.S. GAAP, what incentives does Build-A-Bear Workshop, Inc.'s management have to structure its leases as operating leases? Comment on the effect of leasing on the quality of the company's financial reporting.

By structuring its leases as operating leases, Build-A-Bear Workshop, Inc. does not have to record depreciation expense on the financial statements. Also, all of the leasing expenditures are characterized as operating expenses the actual operating leases do not appear on the balance sheet.

h. If Build-A-Bear had capitalized their operating leases as the FASB and IASB propose, key financial ratios would have been affected.

i. Refer to your solution to part *f*, above to compute the potential impact on the current ratio, debt-to-equity ratio and long-term debt-to-assets ratio at January 2, 2010. Is it true that the decision to capitalize leases will always yield weaker liquidity and solvency ratios?

	Operating Lease	Capital Lease
Current Ratio	1.66	1.68
Debt-to-Equity Ratio	0.73	1.84
Long-Term Debt-to-Assets Ratio	0.13	0.47

By capitalizing leases, the ratios all increase, indicating weaker liquidity and solvency.