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Survey of Accounting Principals in Generally Accepted Accounting Principles and Financial Statement Analysis

By

Hunter Lovell Lawrence

A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements of the Sally McDonnell Barksdale Honors College in conjunction with the E.H. Patterson School of Accountancy.

Oxford, MS

May 2019

Approved by:

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Advisor and First Reader: Dr. Vicki Dickinson

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Second Reader: Dr. Mark Wilder, Dean, Patterson School of Accountancy

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Abstract

For my senior research thesis I decided that I would do research on various case studies that are in the field of accounting. Accounting is my major here at the University of Mississippi and I wanted to do research on a topic that is relevant to my major. I was provide a series of cases about all different subject in the accounting world. These topic were given to me by my instructor and I was to fo through each case thoroughly and answer all the questions. If I didn't know the answer to the question or needed more insight on the subject I would use my intermediate Accounting book for more insights. Through the various case studies, I was able to go into more depth than my traditional accounting classes. The case studies also provided me with a real world application of accounting. These cases simulate real world accounting issues and I was able to apply my knowledge in real life situations. I am very thankful for doing this thesis. I have learn more about accounting through the case studies and has helped me in my classes. The cases have also helped me in the business world as well. During several of my internships, I have used the knowledge and experiences while doing this thesis and applied them to my job. I conclude that this thesis has helped me I ways that I didn't realize going into the thesis.

Accounting 420: Case 1

By: Hunter Lawrence

September 4, 2017

Home Heaters:

Eads Home Heaters, Inc.

&

Glenwood Home Heaters, Inc.

1. Executive Summary

This report provides crucial analysis of the current and future profitability and the overall financial stability of Eads Home Heaters, Inc. and Glenwood Home Heaters, Inc. Through the use of the three key financial statements, it shows that both companies are profitable and financially stable. This is a positive for both companies making them desirable for potential investors and creditors to invest money to further the longevity of the companies. I would recommend to both companies to invest into more into their marketing campaign in order to increase sales revenues. I would also recommend to Eads Company to rent equipment instead of leasing in order to save on Depreciation Expense of leasing equipment. Although three of the key financial statements were listed in the report, this report fails to display a Statement of Cash Flows for the company. Without the Statement of Cash Flows, this report is unable to provide relevant information about the cash receipts and cash payments of each company during the allotted time period.

2. Eads Home Heaters, Inc.
   a.

Eads Home Heaters, Inc.		
Balance Sheet		
For Year Ended December 31, 20X1		
Assets		
Current Assets		
Cash		$ 7,835.00
Accounts Receivable	$ 99,400.00	
Less: Allowance for Doubtful Accounts	$ (4,970.00)	$ 94,430.00
Inventory		$ 51,000.00
Total Current Assets		$153,265.00
Property, Plant, And Equipment		
Land		$ 70,000.00
Building	$350,000.00	
Less: Acc. Dep. Building	$ (10,000.00)	$340,000.00
Equipment	$ 80,000.00	
Less: Acc. Dep. Equipment	$ (20,000.00)	$ 60,000.00
Leased Equipment	$ 92,000.00	
Less: Acc. Dep. Leased Equipment	$ (11,500.00)	$ 80,500.00
Total Property, Plant, and Equipment		$550,500.00
Total Assets		$703,765.00
Liabilities and Stockholder's Equity		
Current Liabilities		
Account Payable	$ 26,440.00	
Interest Payable	$ 6,650.00	
Total Current Liabilities		$ 33,090.00
Long- Term Liabilities		
Notes Payable	$380,000.00	
Lease Payable	$ 83,360.00	
Total Long- Term Liabilities		$463,360.00
Total Liabilities		$496,450.00
Stockholder's Equity		
Common Stock	$160,000.00	
Retained Earnings	$ 47,315.00	
Total Stockholder's Equity		$207,315.00
Total Liabilities and Stockholder's Equity		$703,765.00

b.

Eads Home Heaters, Inc.			
Income Statement			
For Year Ended December 31, 20X1			
Sales			
Sales Revenue			$ 389,500.00
Cost of Goods Sold			$(188,800.00)
Gross Profit			$ 209,700.00
Operating Expenses			
	Depreciation Expense- Building	$10,000.00	
	Depreciation Expense- Equipment	$20,000.00	
	Depreciation Expense- Leased Equipment	$11,500.00	
	Other Operating Expenses	$34,200.00	
	Bad Debt Expense	$ 4,970.00	
Total Operating Expenses			$ 80,670.00
Other Expenses and Loses			
	Interest Expense		$ 35,010.00
Income Before Taxes			$ 94,020.00
	Income Tax		$ 23,505.00
Net Income			$ 70,515.00

c.

Eads Home Heaters, Inc.	
Statement of Stockholder's Equity	
For Year Ended December 31, 20X1	
Retained Earnings, January 1	$ -
Add: Net Income	$ 70,515.00
Less: Dividends	$(23,200.00)
Retained Earnings, December 31	$ 47,315.00

d. Analysis

Eads Home Heaters, Inc. did really well this year with a Net Income of $ 70,515. Their allowance for doubtful accounts was a little high, might look into more efficient ways of being able to collect more revenue in the upcoming years. The negotiation of leasing equipment by management was not the most financially strategic decision. It increased their expenses by a significant proportion and also added to their liabilities with a lease Payable account. Overall the company succeed in their first year of business. I would recommend investors to buy into the company but watch carefully on how the company's management moves forward with Eads Home Heaters, Inc.

3. Glenwood Home Heaters, Inc.

a.

Glenwood Home Heaters, Inc. Balance Sheet For Year Ended December 31, 20X1		
Assets		
Current Assets		
Cash		$ 426.00
Accounts Receivable	$ 99,400.00	
Less: Allowance for Doubtful Accounts	$ (994.00)	$ 98,406.00
Inventory		$ 62,800.00
Total Current Assets		$161,632.00
Property, Plant, And Equipment		
Land		$ 70,000.00
Building	$350,000.00	
Less: Acc. Dep. Building	$ (10,000.00)	$340,000.00
Equipment	$ 80,000.00	
Less: Acc. Dep. Equipment	$ (9,000.00)	$ 71,000.00
Total Property, Plant, and Equipment		$481,000.00
Total Assets		$642,632.00
Liabilities and Stockholder's Equity		
Current Liabilities		
Account Payable	$ 26,440.00	
Interest Payable	$ 6,650.00	
Total Current Liabilities		$ 33,090.00
Long- Term Liabilities		
Notes Payable	$380,000.00	
Total Long- Term Liabilities		$380,000.00
Total Liabilities		$413,090.00
Stockholder's Equity		
Common Stock	$160,000.00	
Retained Earnings	$ 69,542.00	
Total Stockholder's Equity		$229,542.00
Total Liabilities and Stockholder's Equity		$642,632.00

b.

Glenwood Home Heaters, Inc.			
Income Statement			
For Year Ended December 31, 20X1			
Sales			
Sales Revenue			$ 389,500.00
Cost of Goods Sold			$(177,000.00)
Gross Profit			$ 221,500.00
Operating Expenses			
_	Rent Expense	$16,000.00	
	Depreciation Expense-Building	$10,000.00	
	Depreciation Expense-Equipment	$ 9,000.00	
	Other Operating Expenses	$34,200.00	
	Bad Debt Expense	$ 994.00	
Total Operating Expenses			$ 70,194.00
Other Expenses and Loses			
	Interest Expense		$ 27,650.00
Income Before Taxes			$ 123,656.00
	Income Tax		$ 30,914.00
Net Income			$ 92,742.00

c.

Glenwood Home Heaters, Inc.	
Statement of Stockholder's Equity	
For Year Ended December 31, 20X1	
Retained Earnings, January 1	$ -
Add: Net Income	$ 92,742.00
Less: Dividends	$(23,200.00)
Retained Earnings, December 31	$ 69,542.00

d. Analysis

Glenwood Home Heaters, Inc. had an excellent year financially with a Net Income totaling $92,742. Their cash is low which provides amble opportunity for investors to invest money into the company. It also allows creditors to lend money to the company, with the company I desperate need for cash they may be more willing to accept a loan with a higher interest rate. I would definitely recommend to potential investors to buy into this company. The company is financially stable with management making strong financially strategic decision moving the company forward in the right direction.

4. Comparison of Both Companies

Glenwood is the more profitable company compare to Eads. Due to using the FIFO method (Glenwood) than the LIFO method (Eads), Glenwood was able to lower their cost of goods sold, which in turn raises their gross profit and eventually net income. Glenwood's management also did a better job by renting their equipment from a company compared to leasing their equipment from a company like Eads. This significantly lowered Glenwood's expenses and in turn made the net income of Glenwood Home Heaters, Inc. higher. I would recommend that investor lean more towards Glenwood than Eads because of the difference in earnings per share. Glenwood has an earnings per share of $21.73 while Eads had an earnings per share of $14.79 (see appendix C). A greater earnings per share show the companies portions to outstanding share of common stock, which is probably the best determinate of a company's stock value.

Accounting 420: Case 2

By: Hunter Lawrence

September 19, 2017

Molson Coors Brewing Company.

a. **<u>What are the major classifications of the income statement?</u>**

1. Operating Section: This section is a report of revenues and expenses of the company's day to day operations. This section includes sales, cost of goods sold, selling expenses and administrative expenses.
2. Nonoperation section: a report in revenues and expenses resulting from secondary activities of the company. These include unusual gains and losses and other revenues and expenses.
3. Income Tax: this section is the reporting of federal and state taxes that apply to the operating revenues of the company.
4. Discontinued Operations: In this section shows the material

b. **<u>Explain why, under U.S. GAAP, companies are required to provide "classified" income statements?</u>**

Classified income statements are helpful in providing the user with useful information to predict the future outflow of the company. It is able to provide more detail about the company's operations. This information is useful for ascertaining the amount of profit generated strictly from the sale of goods and services.

c. **<u>In general, why might financial statement users be interested in a measure of persistent income?</u>**

Income is able to provided user with the ability to see the general trend of the company's net income from the past and present years. The company Molson Brewing Company has had a pretty steady net income in the past three years. This provides information to potential lenders or investors that this company is reliable.

d. **<u>Define Comprehensive Income and discuss how it differs from net income?</u>**

Comprehensive income includes all the changes to equity during a period except those resulting from investments by owners. Comprehensive income statements include all revenues, gains, expenses and loses reported in the income statement, and all gains and losses that bypass net income but do not affect stockholders equity.

e. **The income statement reports "Sales" ad "Net Sales." What is the difference between these two income statement items? Why does Molson Coors Brewing Company report these items separately?**

Sales is the highest amount of revenue a company has generated during a specific time period. Net sales is the difference between sales less sales discounts and sales returns and allowance. Net sales has the ability to show how much money the company is losing due to customers returning products. A low returns and allowance shows the investors that the company is providing a quality product to its customers. The sales discounts allows investors to see if the company is getting paid on time.

f. **Consider the income statement item called "Special items", what is a special item and when does it occur?**

A special item is a large expense or source of income that a company does not expect to reoccur in the future years. The Molson Coors Company separates special items out from other categories of income and expense so investors can more accurately compare the company's number across the accounting periods. Some of these line items include, restructuring of the company, impairments or assets abandonment and unusual or infrequent charges. If the Molson Brewing Company is repeatedly reported special items year after year this could be a red flag to investors because it makes it hard to gauge the company's specific performance across time periods

g. **What is the distinction between "Other income expense", which is classified as a non-operating expense verse a "Special item?"**

Other income and expense are more commonly found in the day to day business transactions of the company where as special items are more random and unexpected by the company.

h. **Refer to the statement of comprehensive income.**

In 2013 the comprehensive income for Molson Brewing Company was $760,200,000. Net income for the year 2013 was $567,300,000. The comprehensive income was higher than the net income of the company. Net income was 74.43% of comprehensive income for year 2013 (see appendix D). It

occurs because comprehensive income includes unrealized gains and loses such as amortization and foreign currency exchange.

i. What is Molson effective tax rate?

The income tax expense for the year was 84 million and the pretax income was 654.5 this results in an effective tax rate of 12.8% for the year 2013 (see appendix D). The reason why the effective tax rate was lower than the normal 35% due operations in foreign countries and effective tax plan for the company.

Accounting 420: Case 3

By: Hunter Lawrence

October 3, 2017

Pearson Plc:

Accounts Receivable

Executive Summary

In Pearson's case study, the main theme is accounts receivable. Throughout the case study we used different financial statements and footnotes to determine the company's total receivables for the year, as well the total amount written-off and returned. I learned that there were different kinds of receivables than just accounts receivable i.e. (trade receivables). I also learned that there are different terms used in different business environments across the world. Lastly, that the use of T-accounts is a great visual representation of the flow of accounts and should be displayed for users in an appendix.

A. <u>What is accounts receivable? What other names does this go by instead?</u>

Accounts receivable are the outstanding debts or invoices a company is owed by its clients. These debts are usually because of some service performed by a specific company for its clients. Accounts receivables come in different forms as well such as trade receivables or just simply receivables.

B. <u>How do accounts receivable differ from notes receivable?</u>

Accounts receivables lines up with revenues generated by the company. Notes receivable is when a specific company that loans out money to a business and receives interest on the note. An example of a company that that usually gives out notes receivable is a bank.

C. <u>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?</u>

A contra account which reduce the normal balance of the associated account. An example of a contra account is allowance for doubtful accounts. Allowance for doubtful accounts takes away from accounts receivable to get net accounts receivable. Two contra accounts associated with Pearson's are provision for bad and doubtful debts and provision for sales returns. These accounts are a subtraction from accounts receivable due to the chance of being uncollected and possible returns.

D. <u>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?</u>

The percentage of sales method uses the company's past credit sales records that have gone unpaid. This estimated portion will represent the company's allowance for doubtful accounts for the current accounting period. With the aging account method is in accordance with the length of time for which the receivables have been outstanding id allocated with a probability or collecting

on that money. The further away from the service date the least likely you are to collect on that specific receivable.

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.

A company needs to generate revenue in order to stay in business. Mangers will not always know that a company will not pay the invoice sent to them. If a certain company continually does not pay or are months late on payments, mangers might have to weigh the option to either continue doing business with the client or to find a new client that will pay on time. Because if the company is not collecting enough cash, they will be in serious financial trouble.

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.
In 2009 the company had trade receivables of 1,419 million. Of those the company allocated 76 million to go unpaid throughout the year. (See appendix E for t- accounts).

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 "utilized") during 2009. For each account in your journal entries, note whether the account is a balance sheet or income statement account.
(See appendix F for journal entries)

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

The provision for bad and doubtful expenses are included in the operating expenses account. This is due to the accounts receivables be in accordance with operating activities of the company.

G. <u>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.</u>

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. (see appendix G)

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. (see appendix H)

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

This contra account is usually referred to as the Allowance for sales returns and allowances. This is a contra revenue account. This happens when customers are unhappy with a certain product and decide to return the product to the company. This usually has a spike around the holidays.

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. (see appendix I)

Accounting 420: Case 4

By: Hunter Lawrence

November 8, 2017

Palfinger Corporation:
Property, Plant, Equipment

Executive Summary:

While reviewing this case I was able to learn a lot about the different aspects of property, plant, and equipment. Palfinger is a company based in Austria that specializes in producing large pieces of machinery. To produce machinery of this size, Palfinger needs a lot of land for production facilities and storage warehouses. Over time these warehouses and production facilities depreciate. In order to properly depreciate these facilities, different kinds of methods can be used. Throughout this case I used these different kinds of depreciation methods in certain scenarios in order to calculate depreciation expense for the year.

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

From reviewing the case, I believe that the Palfinger Company has its own warehouses and manufacturing facility. It would needs its own land to support a facility large enough to host a site for a production facility. It also probably has heavy equipment able to move heavy objects around the plant, such as forklifts and cranes In order to produce such large sophisticated machines, Palfinger might use high-tech robotics in order to assemble the products.

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

The number listed on the 2007 balance sheet for Palfinger Company is the total property, plant and equipment the company owns. This includes all the stuff that could be listed above. This number is the total book value of the property, plant, and equipment at historical cost less accumulated depreciation over the life of the equipment. Palfinger Company uses a straight line depreciation method to depreciate its assets over its lifetime. The typical way to calculate straight line depreciation is take the historical cost minus the salvage value of the asset, then divide by the years of useful life. This will give you the annual depreciation expense for each given asset.

C. What types of equipment does Palfinger report in notes to the financial statements?

In reviewing the notes provided by Palfinger Company, they have their own buildings as well as investments in third-party buildings. A third-party building is like a capital lease from another company that Palfinger reports as an asset on its book. Palfinger also has plant and machinery. Plant refers to the production facilities of the company and the machinery is the assets that the company uses in production. Last, Palfinger owns fixture, fittings, and equipment. These asset accounts are used to move and finish the products that are produced by the company. An example of equipment of the Palfinger Company is a forklift.

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.

A prepayment is a cash payment made in advance that is listed as an asset on the balance sheet. This prepayment might be made in order to acquire a new building for the company. Construction of a building is shown as "construction in progress", which is used as a clearing account. There is not accumulated depreciation because the prepayments and the assets are not yet in use and therefore cannot be depreciated. The €14,958 represent the amount of assets the company put into daily operations for the year and began depreciation on the asset. The asset is then transferred from either the 'prepayments' or 'construction in progress' to the designated asset group.

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 uses the straight-line depreciation method to depreciate its assets over time. Straight line depreciation is the most simple form and most used by form of depreciation by businesses. This allows for better comparability between companies. Also, it is very simple to calculate therefor it is less costly for the company. Straight line is a great way to depreciate buildings. Some of the problems with straight line is that machines don't always perform exactly the same from year to year especially with machinery used in production. Another problem is that some of the life spans of certain assets cannot be reasonably determined by the company. Management might want to move toward calculating depreciation of machinery using the units of production depreciation method. It calculates depreciation expense based on the number of products that the machinery or equipment that can produce during the given year.

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?

If a major renovation and/or value-enhancing modification is made to an asset, it is typically treated as an asset capitalization. With this treatment, the asset is kept on the books, and the cost of the improvement to the asset is capitalized since that is what will ultimately be increasing its book value. An alternative to the capitalization approach is to charge the improvement to accumulated depreciation, which is a situation where the company extends the

useful life of an asset. In this case, the company debits Accumulated Depreciation rather than the asset.

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 Palfinger Company purchase €51,860 worth of equipment during the year of 2007. This is calculated by taking the end of year Property, plant, and equipment for 2007 minus the ending balance of 2006. This difference give you the purchases of new property, plant, and equipment for the Palfinger Company.

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

Government grants are resources transferred by the government to an entity usually upon some sort of conditions. Government grants can be either monetary or non-monetary. In order to set up a grant related to an asset, the company is required to deduct the grant from the carrying amount of an asset. This is the reason for the deduction from property, plant, and equipment.

iii. Depreciation expense for fiscal 2007.

As referred to above, the Palfinger Company uses the straight line depreciation method throughout its operations. The depreciation expense for the year was €15,638, found on the income statement.

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

In reviewing the notes provided by Palfinger Company, the amount of property, plant and equipment is €6,820. Most companies tend to dispose of their assets by selling them either above or below book value. If a company sells the asset, they will recognize a gain. If the company sells an asset below book value, they will recognize a loss. These recognition of either a gain or a loss will be made on the income statement and the statement of cash flows.

H. <u>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 fiscal 2007. Calculate the gain or loss that Palfinger incurred on this transaction.</u>

Palfinger would report a gain of €1,070 for the disposal of property, plant, and equipment for 2007. (see appendix J for numbers)

I. <u>Consider the €10,673 added to "Other plant, fixtures, fittings, and equipment" during 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 a full year of depreciation in 2007 and the company uses:</u>

i. Straight-line Depreciation.

Straight Line Depreciation			
Year	Book Value	Depreciation Expense	End Year Book Value
2007	€ 10,673.00	€ 1,880.00	€ 8,793.00
2008	€ 8,789.00	€ 1,880.00	€ 6,909.00
2009	€ 6,909.00	€ 1,880.00	€ 5,029.00
2010	€ 5,029.00	€ 1,880.00	€ 3,149.00
2011	€ 3,149.00	€ 1,880.00	€ 1,269.00

ii. Double-declining balance depreciation.

Double-Declining Balance Depreciation			
Year	Book value	Depreciation Expense	End Year Book value
2007	€ 10,673.00	€ 4,269.20	€ 6,403.80
2008	€ 6,403.80	€ 2,561.52	€ 3,842.28
2009	€ 3,842.28	€ 1,536.91	€ 2,305.37
2010	€ 2,305.37	€ 922.15	€ 1,383.22
2011	€ 1,383.22	€ 110.22	€ 1,273.00

J. <u>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.</u>

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.*).

The impact that this transaction would have on Palfinger's income statement is a loss in the amount of €617. Since depreciation is not taken during the year of the sale (2008), the depreciation expense stays at €1,880 on the income statement, which is the amount of depreciated recorded in 2007 when the equipment was added.

Cash	7,500.00	
Accumulated Depreciation	1,880.00	
Loss on sale	893.00	
Equipment		10,673.00

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.*).

The impact of this transaction would have Palfinger's income statement of a gain in the amount of would be a gain in the amount of €1,096.

Cash	7,500.00	
Accumulated Depreciation	4,269.20	
Gain on sale		1,096.20
Equipment		10,673.00

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

With the double declining balance, Palfinger would be able to report a gain on its income statement rather than with straight line having to record a loss. This will increase the overall profits of the company, which in turn will keep investors of the company happy.

Accounting 420: Case 5

By: Hunter Lawrence

November 22, 2017

Volvo Group: Intangible Assets.

Executive Summary.

Volvo is a car manufacturer that is located in Torslanda, Sweden. Volvo Group employs over 90,000 people in production facilities located in 19 countries. Volvo prides themselves in trying to be the leader of innovation and technology in the car manufacturing industry. Volvo in order to stay ahead of their competition has to incurred a great deal of research and development cost that affects their net income. Due to IAS 38, it is difficult to determine what is considered research and what is considered development in order to properly report information on the financial statements. In order to be classified as an intangible asset, it must be determined to have future economic benefit for the company. Any research done by the company cannot be recognized as an intangible asset, but shall be recognized as expenditure of the company. While working on the case, I learned how to report different situations of intangible assets in accordance with IAS 38 on the financial statements of the company. I also learned how to capitalize product development cost that affect the balance sheet, income statement, and the statement of cash flows. Finally, I learned how to adjust the financial statements to compare U.S. standards to the international standards of R&D methods of accounting. This case furthered my knowledge on intangible assets and will hopefully translate later on in the business world.

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?**

Research and development is a crucial part of any company. In order to stay at the tip companies are constantly innovating new products and ideas. With the innovation comes cost for the company, some of these cost include the labor cost associated with people working on the new product or ideas. An example would be, a lab researcher aimed at the discovery of new knowledge; searching for applications of new research findings. Some of the cost associated with the development activities would be the conceptual formulation and design of the product or process alternatives.

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 has to designate what is considered research and what is considered development. This option is very subjective to the company applying IAS 38. If the company considered certain things to be listed as research, then no intangible asset arising from research or from the research phase of an internal project shall be recognized. It should be recorded as an expense. But if the company designates it as development, Volvo will be able to capitalize it. In order to be capitalize it must meet the following criteria listed by IAS 38 section 57.

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?**

When a company decides to amortize and capitalize its products, the company needs to consider the future benefits of that product. Intangible assets have either a limited useful life or an indefinite useful life. The amount of amortization expense for a limited-life intangible asset should reflect the pattern in which the company consumes or uses up the asset, if the company can reliably determine that pattern. An indefinite life means that there is no foreseeable limit on the period of time over which the intangible asset is expected

to provide cash flows. A company does not amortize an intangible asset with an indefinite life.

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 think that the U.S. GAAP ruling on that all R&D cost must be expensed is better suited for the business world. With having to capitalize every year or even every month, companies will have higher administrative cost in order to account for these changes. The decision of whether or not something could be considered research or could be considered development is subjective from company to company. With the U.S. GAAP requiring all R&D to be expensed, this will allow for more consistency of reporting of financial statements from company to company.

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 amount of capitalized for products and software for year 2009 is 11,409. This amount would be listed in the intangible asset account for the Volvo Group.

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.**

Capitalized Product & Software, net

Beg. Bal. (2009)	12,381		
Capital Exp.	488		
		Amortization	3126
			488
End Bal. (2009)	11,409		

F. **<u>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 that Volvo capitalizes.</u>**

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

(in SEK millions)	2007	2008	2009
Product and software development costs capitalized during the year	2,057	2,150	1,858
Total R&D expense on the income statement	11,059	14,438	13,193
Amortization of previously capitalized cost	2,357	2,864	2,830
total R&D cost incurred during the year	10,759	13,634	12,221

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

2007- 2,057/10,759 = 19.12%
2008- 2,150/13,634 = 15.77%
2009- 1,858/12,221 = 15.20%

G. **<u>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.</u>**

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

(in US $ millions)	2007	2008	2009
Net sales, industrial operations	285,405	303,667	218,361
total assets, from balance sheet	321,647	372,419	332,265

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

Over the course of 2007-09 the average percentage of research and development cost of the company Navistar were roughly 3.21%. For Volvo over the course of those same three years, their average percentage of research and development compared to net sales was around 4.88%. These number represent a difference of 1.66% between Navistar and Volvo. Since Volvo is a larger company compared to Navistar, Volvo might be expected to have a higher research and development cost due to always trying to stay ahead of the competition and the leader in innovation. This could be the reason why Volvo has a slightly higher percentage of R&D compared to sales. Volvo might need to reduce spending on R&D, because their net income has significantly declined in 2009 from net income in 2008, which also lead to percentage of R&D to sales to rise sharply as well.

Accounting 420: Case 6

By: Hunter Lawrence

January 30, 2018

IDEA by Caseware

Executive Summary:

This case allowed us to pick an individual data analytics tool that is used in the accounting realm. The tool I pick was IDEA by Caseware, which is a data analytics tool that can perform over 100 audit related functions. IDEA is helpful in many different areas besides just audit, as it is able to analyze 100% of company's data securely. This allows for no data breaches by employee or outside sources. This case has informed me that there are many different data analytics tools out in the business world and no tool can solve every problem. Each tool has a specific purpose and sometimes companies may have to employ more than one tool in order to achieve the results need for an optimal business strategy.

1. **History of IDEA by Caseware**:

IDEA by Caseware is one of the industry leaders in in providing technological solutions for finance and accounting. Founded in 1988, IDEA has grown to over 400,000 users in 130 countries translated in 16 different languages. This makes IDEA a useful tool for multi-national economic entities. IT is the flagship product of Caseware and is constantly improved in order to ensure the quality of their product. IDEA is a user friendly tool that enables users to quickly perform data analytics to improve audits externally and internally while also being able to identify areas of control breakdown. IDEA also guarantees the safety of all the company's data by only allowing users to deceiver data in the read-only format. IDEA is a great product to ensure that your data is secure while still maintaining the speed to quickly perform data analytics in paving the way for faster more effective audits.

2. **Skills Needed to Use IDEA by Caseware:**

IDEA by Caseware is a very simple tool that is useful in making many decisions. Since it is very simple a student could easily learn how to use and implement their knowledge in a business environment. By logging onto the Caseware website, students have the ability to use the tutorial videos available by Caseware to increase their knowledge on IDEA. Each video will improve the students ability to perform the simple task that IDEA was designed to quickly solve. A simple knowledge in accounting and functions of a PC platform is all that a student needs in order to navigate IDEA. Another great way to learn more about the benefits and the uses of IDEA is to attend their annual conference, which discuss the improvements made to the software and the potential new uses coming in the future. This is a great way to stay informed on the product and be able to master your skills in uses IDEA. People from around the globe meet to learn more about this innovative new product.

3. **How to use this tool in the business world?**

A.) Audit

i. Companies often perform internal audits in order to gain perspective on their company's situation. Internal audits are beneficial in preventing fraud, testing internal control, and monitoring companies with certain company policy and government regulations. Establishing an internal audit function can be costly for companies that are have location across the globe. IDEA by Caseware is a great tool as it is translated in to 16 different languages. IDEA allows internal auditors to perform 100% of the company's data regardless of variety or volume, which allows internal auditors to be confident in the conclusions drawn from the data. It gives auditors the power to perform over a 100 audit-

relevant task with ease. Lastly, it allows audits to be performed in real-time making the entire audit team able to share the data analytic insights in a timely manner. This makes for a timelier audit in order to fix some of the holes in the company before they are exposed and a more cost-effective way for a company to perform an internal audit.

ii. Every year companies are required by law to have an accounting firm come in to perform an external audit of the company. External auditors are accountants who work independently of a particular company. They examine company records and operations to ensure that financial statements are accurate. Their role is to give an opinion of the financial statements reflection of the status and operations of the company being audited. Based on what they witness during the audit they will also produce, for management and board utilization, a management letter. Although a financial statement audit is the most common type of external audit, external auditors may also conduct special purpose audits which might include; performing specific tests and procedures and reporting on the results, a less intensive review, and compilations. With Caseware Analytics technology, external auditors can assess data from multiple sources, to efficiently detect fraud and errors, as well provide insights into the overall health of internal controls within an organization. External auditors are now able to gain valuable information on their client's financial records in order to quickly perform the external audit and provide more accurate results.

iii. IDEA may be used in the misappropriations of assets that a company can incur. A misappropriation of assets is a type of fraud that usually happens between an employee and its employer. The employee usually commits theft of the company's cash or other assets. THIs could happen a lot within a non-profit industry, were there is no net income. So an employee finds an excess of cash, he might allocated the excess cash to his salary expense in order to still have a bottom line of zero but at the same time pocketing some cash for himself. An accounting from an outside firm doing an audit might not know how much that employee is specific supposed to be paid and could not catch the inconsistency. But is the external auditors apply IDEA by Caseware to help do the audit, while analyzing 100% data could be able to catch the mistake or misrepresentation of salary by the employee. Using IDEA to detect fraud like this, could end up saving the company a lot of money and the ability to present facts to terminate the employee that has committed the fraud.

B.) Tax Planning

i. Tax planning is the process of organizing your affairs in ways that postpone the payment of taxes or avoiding taxes in general. Companies that employ effective tax strategies are able to have more money to save and invest into

future endeavors. With new taxes laws in place for the 2018 fiscal year, corporations are looking for tools that will be able to process the new tax code in order to save them the most money possible. The money saved by these tools corporations are able to pay off their debt owed to creditors. Another way corporations are going to use the money is to give employees bonus and use the extra capital to hire more workers. This new tax reform is proving beneficial for America's large corporations and any data analytics tool that will save the company the most money will be highly valuable.

ii. How exactly does IDEA enable auditors to examine tax returns to save the companies the most money to invest in the future? IDEA is able to reconcile all the general ledge entries, financial statements and tax returns. IDEA is able to sort through sales transactions that have happened over the course of the year and identify the proper amount of sales tax the company has incurred during the year. This comes in handy when filing the tax return at the end of the year for the company. Whether a company is preparing their tax returns internally or hiring an outside accounting firm to prepare the tax return for them, companies should use IDEA in preparations of the tax returns.

iii. Many of the world's largest corporations are multinational companies. This means that these companies have to abide to the different tax laws of each individual country. Accounts spend many hours working on the tax returns of these large companies; they are working hard on finding ways to pay the lowest amount legally owed by the company. This process is often tedious and very time consuming. IDEA is able to take the data on each countries tax laws and rapidly compute the total number either owed or returned to the company on their tax return. This makes the job of the accountant a lot easier in processing tax returns. It also is more reliable than just traditional tax return preparation.

C.) Financial Statement Analysis/ Valuation/ Advisory

i. IDEA is able to work with the financials of a company to easily interact with the different financial functions of the company to provide a simple view of the company's financial controls. IDEA is best for companies that are serious about reducing fraud within the organization. AT the same time, IDEA will be able to reduce the inaccuracies and inconsistencies produced in financial statements. This ensures that a company is properly reporting their financial statements. With financial statements properly recorded, it allows auditors to spend less time auditing the company and eventually decreases the overall cost of an audit.

ii. In industry IDEA can help process large data stored on company servers in order to improve operational efficiency. The prescriptive modeling function that IDEA provides can help companies anticipate new revenue streams, while at the same time project new business markets the company should look into. The main reason companies are willing to expand into new markets is to increase sales. IDEA will show markets that can benefit the company and will show markets that the company should avoid entering. This is very beneficial it saves the company a lot of money by not hiring an outside advisory company. It also saves them time by getting real time results from IDEA. This comes in handy for a marketing team preparing a marketing plan on short notice to present ideas for areas of expansion into new countries. IDEA gives up to date data on the customer of the area, habits and tendencies.

iii. Financial advisors often have many clients, which means many different stocks that each client is invested in. The challenge of many financial advisors is to turn important big data into business value. IDEA is able to use predictive analytics in financial services to analyzes massive data sources and prescribe useful actions to rapidly improve the overall business decisions the benefit the client of the financial advisor. Predictive analytics in financial serves can directly affect the overall business strategy for each individual client by being more efficient in stock predictions based on big data. Predictive analysis also is prepared so quickly, which allows financial advisors the ability to quickly make decisions that will generate more revenue for the client while minimizing risk. When clients are making more money so is the financial advisor.

4. Present Why We Should Invest in IDEA by Caseware:

In order to help produce faster and more accurate audits for future clients, I believe that our company should invest in the software tool IDEA by Caseware. IDEA by Caseware is a data analytics tool that enables users to securely analyze data of a company producing quick analysis for more effective audits of a company. In order to use IDEA several member of an audit team will have to be thoroughly trained in the different uses of the tool. This will cost money for training but IDEA has over 100 audit-related functions. This tool could eliminate several members of an audit team, allowing the audits of companies to be cheaper. With audits being cheaper, that means less revenue generated by the firm but at the same time less salary expenses paid by the firm. In order to see if implementing IDEA as a tool used by our firm, we must see if the total revenues by using this tool will ultimately outweigh the cost. If that statement is to be true, then I think this company should move forward by using IDEA to perform all external audits of clients.

Accounting 420: Case 7

By: Hunter Lawrence

February 9, 2017

Rite Aid Company: Liabilities and Long Term Debt.

Executive Summary.

This case is all about the Rite Aid Company, which is a large retail pharmacy store located in the United States. Rite Aid fills pharmacist prescriptions of medicine for customers, but also provides an assortment of products as well. In this case, I looked into specifically Rite Aid's long term debt. Long term debt is made up of financial obligations that last longer than one year. Some examples of long term debt are company bond issuance or long-term leases that are capitalized on a company's balance sheet. More specifically in this case I focused at looking at specific bonds that Rite Aid has issued and to what effects they have on long term debt. From the case, I learn the difference between secured and unsecured debt when in accordance to taking out loans. I also learned about convertible bonds and how that companies are able to issue different types of bonds for different situations. Last this case has helped me practice journal entries for the issuance of bonds, which will help me prepare for my other accounting classes that I am taking.

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?

Secured debt is a type of debt that is backed by collateral to reduce the risk of the debt being uncollected. If a barrower of secured debt defaults on their loan, the lender is able to seize the assets put up for collateral. This is the reason creditors are sometimes more worried about the value of the company's assets rather than looking strictly at the company's profits. Companies can easily sell off their assets in order to pay off their debt in situations where there is an earnings loss. Secured debt is very common in companies that have a poor credit rating. An example of a secured debt is a mortgage on a house or some type of property owner by a lender. Lender prefer secured debt because it is less risky and creditors know they will receive part of the money owed to them if the company fails to make payments. Unsecured debt is a loan that doesn't have an asset held as collateral against it. This is a type of high risk for creditor therefore not preferred due to the riskiness. With unsecured debt there tends to be high interest rates associated with the loans. If a company cannot pay back their unsecured debt, the company can avoid paying the debt by declaring for bankruptcy. Some examples of unsecured debt is credit card debt, medical bills, and utility bills. Rite Aid separates there two types of debt on the balance sheet in order to signify to shareholder and creditors how much of each type of the debt the company holds. This allows creditors visually to see whether or not Rite Aid has the ability to pay them back if Rite Aid defaults on their loans.

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?

A loan guarantee is a lot like secured debt except that an asset is not put up for collateral. If a borrower does end up defaulting on the loan, a third party might pick up the loan obligations in order to give the borrower the necessary time to repay the loan. Sometimes the best options is to try and refinance the debt obligations with the lender as the lender will debit the loss of the loans to Bad debt expense or write them as uncollectable. Rite Aid's wholly owned subsidiaries guarantee the loan obligations under the senior secured credit facility.

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

A senior bond or senior debt is a type of debt where if the company files for bankruptcy or is going out of business must be paid first. Due to financing having different priority levels if the company is liquidating all its assets a senior loan/ debt will be paid first. Senior debt is secured and therefore tends to have a significantly lower interest rate due to the fact it has priority over all other types of financing activities. A fixed rate is where an interest rate on a liability like, a loan or mortgage, is obligated to the stay the same until the bond matures. This is either very beneficial or detrimental to a barrower. If interest rates go up while holding a fixed rate bond, the borrower will not have to make the higher interest payments ono the loan. But if interest rate decline over the term of the bond then the company still has to make the higher interest payments. A convertible bond is a type of debt security that can be converted into a predetermined amount the underlying company’s equity. Convertible bonds provide for a flexible financing option for companies. Most of the time convertible bonds are issued at lower borrowing cost due to the additive value of being able to trade them into company stock.

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

There are several reasons why a company has different interest rates. One, market rates are constantly changing. There are times where interest rates are low and times where interest rates are high. Second, as discussed earlier in the case there are different types of debt, unsecured debt and secured debt. With unsecured debt typically higher interest rates are associated with this kind of debt due to it being a riskier option. With secured debt, since an asset is held as collateral against it interest rates can tend to be lower. But in Rite Aid’s case their interest rates for secured debt are higher than their unsecured debt. This could be due to the fact that Rite Aid is having a cash problem. By looking at the balance sheet, Rite Aid’s accounts receivables has increased significantly from 2009 to 2010. If accounts are not being collected on Rite Aid is now receiving the necessary cash to keep up with the day to day business expenses. Rite Aid needs to improve their collection process. Since Rite Aid is having a cash flow problem, this might induce more borrowing by the company which can drive their interest rate up to as high as 10.375%. Finally, creditors can also notice that Rite Aid is struggling an in fear of not getting a return on their investments are charging higher interest rates on the front end with an option to refinancing later if Rite Aid’s financial position improves.

B. <u>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.</u>

Rite Aid has total debt on its balance sheet of $6,370,899. Total debt it calculated by adding current maturities of long term, long term debt and leasing financing obligations together. The current maturities of long term debt due within the fiscal year is $51,502. The amount in Note 11 is the same amount list on the face of the balance sheet.

C. **<u>Consider 7.5% senior secured notes due March 2017</u>**.

i. What is the face value of these notes? How do you know?

The face value of the 7.5% senior secured note due March 2017 is $500,000. Since the amount isn't amortized from year 2009 to 2010 the market rate and the state interest rate are the same. Since the market interest rate and the stated interest rate are the same then the bond sold at par value.

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

	Debit	Credit
Cash	$500,000	
Bonds Payable		$500,000

iii. Prepare the annual interest expense journal entry. Note that the interest paid on the note during the year equals the face value of the note time the stated rate of the note.

	Debit	Credit
Interest expense	$37,500	
Cash		$37,500

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

	Debit	Credit
Bonds Payable	$500,000	
Cash		$500,000

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

i. What is the face value of these notes? What is the carrying value of these notes on February 27, 2010? Why do the two values differ?

The face value of the 9.375% note due December 2015 is $410,000. The carrying value of the note is $405,951. In order to calculate the carrying value of the note, take the face value of the note subtracted by the unamortized discount to get the carrying value of the note. This is because the bond sold at a discount therefore we have to amortize the note back up to the face value of $410,000.

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

Rite Aid paid $38,438 in cash for year 2009. In order to calculate the cash paid for the year, the company will take the face value of the note payable and multiply it by the stated interest rate of the note to get cash payable.

iii. Determine the total amount of interest expense recorded by Rite Aid on these notes for the year ended February 27, 2010.

Rite Aid paid $39,143 in interest expense for year 2009. In order to calculate interest expense we must take the carrying value of the note and multiply it by the effective interest rate in order to get interest expense for the year. In this case we aren't given the effective interest rate so we find the number $39,143 by taking the difference of the unamortized values in year 2009 and 2010, which equals $705. Then take the $705 and add it to the cash calculated earlier in the case, which was $38,438, to get the company's interest expense for the year.

iv. Prepare the journal entry to record interest expense on these notes for the fiscal year 2009.

Account	Debit	Credit
Interest Expense	$39,143	
Discount on Bonds		$705
Cash		$38,438

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

This is calculating for the effective interest rate on the note. In order to calculate the effective interest rate on the note, take the interest expense

recorded for the year and divide it by the carrying value of the note at beginning year 2009.
$39,143/ (405,951-705) which gives the value of 9.659% effective interest rate for year 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 Bonds	$7,380	
Bonds Payable		$410,000

Cash is calculate by taking the face value of the note, which is $410,000 multiplied by the percent of proceeds of 98.2% to get $402,620. If the percent of proceeds is less than 100%, then the bonds sell at a discount, which is the case here. Whereas if the percent of proceeds is greater than 100%, then the bonds will sell at a premium rate. When there is a discount on the bond the company must amortize the bond back up to its face value. There are several different methods to amortizing bonds. Two most common are the straight line method or the effective interest rate method. With the straight line method companies take the discount on bonds and divide by the number of interest payments, periods, which will be made on the bonds. This means that all cash, interest expense and amortization will be the same in every pay period. The second way is the effective interest method, which take the carrying value of the bond multiplied by the effective or market rate of the bonds to calculate interest expense for the year. This gives the company different interest expense payments from pay period to pay period. In this situation, Rite Aid is amortizing their bonds using the effective interest method.

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

The effective annual rate of interest is also called the market rate of interest. Since Rite Aid's bonds sold at a discount, this means the effective interest rate is higher than the stated or face rate of the bonds. If the bonds sold at a premium, then the stated rate of the bonds would be higher than the market rate. In order to calculate the effective interest

rate, use excel and type in =RATE. Then type in the periods being amortized, cash payments on the note, present value of the note, and finally the future value of the note. Note that when enter in the payments and the face value of the note, enter them in as negatives as they are cash outflows. The final equation should look like this, =RATE(7, -39975, 402620, -410000). This should give Rite Aid the effective interest rate off 10.121% on their bonds.

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.**

Year	Cash Payment	Interest Expense	Discount Amount	Carrying Value
2009				$ 402,620.00
2010	$ 39,975.00	$ 40,749.98	$ 774.98	$ 403,394.98
2011	$ 39,975.00	$ 40,828.41	$ 853.41	$ 404,248.39
2012	$ 39,975.00	$ 40,914.79	$ 939.79	$ 405,188.18
2013	$ 39,975.00	$ 41,009.91	$ 1,034.91	$ 406,223.08
2014	$ 39,975.00	$ 41,114.65	$ 1,139.65	$ 407,362.73
2015	$ 39,975.00	$ 41,230.00	$ 1,255.00	$ 408,617.73
2016	$ 39,975.00	$ 41,357.02	$ 1,382.02	$ 409,999.75

iv. **Prepare the journal entry that Rite Aid would have recorded February 27, 2010, to accrue interest expense on these notes.**

Account	Debit	Credit
Interest Expense	$27,167	
Discount on Note		$517
Interest Payable		$26,650

To calculate the accrued interest, take the full interest expense amount for the year and multiply by 8/12, because 8 months have accrued to get your interest expense number to be accrued at February 27, 2010. $40,749.98 * 8/12 = $27,167. In order to get the payment do the same method, $39,975 * 8/12 to get $26,650. Rite Aid's discount is just a plug figure of $516. Since Rite Aid is accruing the interest payments the journal entry instead of cash needs to be Interest Payable.

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

To find the carrying value at February 27, 2010, take the original carrying value of the note and since it was issued at a discount, add back the discount on the note for the accruing period to get new net carrying value of $403,136. Example $402,620 + $517 = $403,137

Accounting 420: Case 8

By: Hunter Lawrence

February 23, 2017

Merck & Co: Statement of Stockholders Equity

Executive summary:

In this case, we interpreted the shareholders' equity disclosures to find the effects of the selling and repurchasing of treasury stock. We also analyzed the effects of different dividends on the account and how to work backwards with the information provided in the statement of cash flows and the balance sheet. I found it very interesting to figure out the different reasons that companies would pay out dividends to shareholders. It opened my eyes to a couple of different ways to look at common stock and dividends paid out.

A. Consider Merck's common shares

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

Companies are only allowed to issue as many shares as the company charter states. A company charter is a written document that is filed with a U.S. state by the founders of the corporation. Listed in the charter is the major objectives of the company and the different strategic operations the company has in place to accomplish their goals. When the charter is approved by the state government, the company becomes a legal corporation. Merck has listed in its charter that it is only allowed to authorize 5,400,000,000 shares of the company.

ii. How many common shares has Merck actually issued at December 21, 2007?

According to the Stockholders Equity section of Merck's balance sheet, Merck has 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.

Looking at the balance sheet for Merck 29,835.1 million shares that were reconciled at December 31, 2007.

iv. How many common are held in treasury at December 31, 2007?
On December 31, 2007 there are currently 811,005,791 shares currently held in treasury for the Merck Company.

According to the balance sheet and the statement of cash flow, Merck currently has 811 million shares outstanding.

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

There are 2,172,502,884 share outstanding at the end of the fiscal year for 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.

In order to fins market capitalization, a company will take the market value of the stock traded multiplied the number shares outstanding.
2,172,502,844 x $57.61 = $125,157,891,147

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

Dividends are corporate earnings that are distributed to their shareholders. There are different kinds of dividends such as cash dividends, stock dividends, or property dividends. Dividends are usually associated with a company's success, and can reflect the financial state of the company, Companies that pay dividends attract investors which are more likely to buy the company's stock which helps in raising capital. Larger companies that are stable will pay dividends to their investors. Sometimes companies choose not pay dividends. The main reason a company will not pay dividends is because they don't have the necessary capital to pay them. Another reason a company won't pay dividends is because they are rapidly expanding and want to use the capital to grow the company.

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

When a company decides to repurchase its stock this is considered a stock buyback. If a company decides to buy back its stock, the issuing company will pay market value per share to acquire the shares. The most likely reason for a company to repurchase shares is to take back a portion of ownership which was originally held among public and private investors. When a company sales a share of common stock, it not only sells the stock but all the rights that come with the stocks. One of the rights that are associated with a purchase of the stock is the right to vote on business decisions and direction. If management is unhappy with the some of the stockholders decisions then they can buy back their stock. Another reason why a business would repurchase their share is to improve their Earnings Per Share or EPS. By reducing the number of share outstanding, the company's EPS ratio is increased in the short term. With a higher EPS, the company seems like a good investment decision.

D. 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

E. 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 to account for treasury stock. When companies account fo the cost method for treasury stock they debit treasury stock and credit common stock. In order to find the cash paid for treasury stock at the time the company must take the shares repurchase times the market value of the shares.

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

When trying to find the number of share that Merck repurchased for the year, use the statement off cash flows. Merck repurchased with 26,500,000 shared for the year.

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?

The type of cash flow in this situation is a financing activity. In order to repurchase their own shares Merck spent $1,429,700,000.

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

Treasury stock is not considered an asset because it has a future benefit. Treasury stock is rather considered a contra equity account.

F. Determine the missing amounts and calculate the ratios in the tables below.

Over the past two years the dividend related ratios are decreasing except for the dividend payout ratios.

	2007	2006
Dividends Paid	3,307,300,000	3,322,600,000
Shares Outstanding	2,172,502,884	2,167,785,445
Net Income	3,275,400,000	4,433,800,000
Total Assets	48,350,700,000	44,569,800,000
Operating Cash Flows	6,999,200,000	6,765,200,000
Year-end Stock Price	$57.61	$41.94
Dividends Per Share	1.52	1.53
Dividend Yield	0.026	0.036
Dividend Payout (dividends paid/NI)	1.01	0.75
Dividends to Total Assets (dividends paid/total assets)	0.068	.075
Dividends to Operating Cash Flows (dividends paid/operating cash flows)	.472	.49

Accounting 420: Case 9

By: Hunter Lawrence

March 21, 2018

Tax Shelters.

Executive Summary:

This video was very interesting and informative. It shed light on a topic I wasn't quite familiar with and at the same time was interested in. I learned how a tax shelter is created and how it is kind of genius the structure of the tax shelters. I learned about the morality that comes with establishing a tax shelter and how there is a thin line between tax minimization and tax evasion. As a British prime minister said "the difference between tax avoidance and tax evasion in a prison wall" clearly shoes the thin line that companies walk to pay the least amount of taxes possible.

In order to understand what a tax shelter is, we must be able to define and understand how a tax shelter works. A tax shelter is a financial arrangement made for a specific company in order to avoid or minimize taxes for the corporation. There are different ways that corporations can avoid paying a full amount of tax owed on their profits. Corporation are able to flow their profits through different countries in order to make sure they pay the least amount of tax possible. Corporation set up subsidiaries, which are often just a post office box, to flow their profits through. Some of the main countries that corporations use are the Netherlands, Cayman Islands, Panama, and Bahama's. Though most people would consider this kind of activity illegal but most tax shelters are legal by definition. The argument comes to whether the action of activity of having a tax shelter is morally right or not.

Corporations are constantly trying to demonstrate how socially responsible there are and how they care about their communities. Now most corporations do their jobs by giving back to the community through charitable donations or having a service day for the entire company. These things are great in all but another way a corporation can give back to the community is by paying taxes. In 2017, it is estimated that the US government lost around $70 Billion dollars in corporate taxes. These taxes could help in public works projects, homeland security, or used to increase jobs in the US. So, if a corporation says they are socially responsible shouldn't they also be paying their taxes? That is the question that is raised in a public hearing in the UK in 2012. Three large corporation were represented at the hearing and were questioned on why they pay such low taxes and if they are reporting negatives profits why are they still in the European market. Which makes complete sense, why would a corporation continue to do business in a market when for the last "12 years" they have reported negative revenues. Any business man would understand after three years that this market is not working out and move their business elsewhere. So who is to blame for these tax shelter?

In the video it talks about how there are three main components in the establishment of a tax shelter, lawyers, accountants and banks. Focusing on the accounting side of tax shelters. Tax partner's jobs are based upon finding ways the corporation can save the most amount of money on paying taxes. So as a hired service of the specific corporation, it is the duty of the accounting firm to be able to legally save the corporation the most money. Often times that is through tax shelters. Is this wrong doing by the accounting firms? I don't believe so, because if one firm is not willing to establish these tax shelter their clients will move on to other firms that are willing to

provide that service for them. Ultimately it is a strategic business decision by the accounting firms to establish these tax shelters. I think the same goes for lawyers and banks as well. Accounting firm's ultimate goal is to generate revenue for the firm itself and losing large clients like Apple, Amazon, and Starbucks could drastically cut revenues of the firm and lead to layoffs.

There is a need for change. It is estimated that US Corporations hold roughly around $2.1 trillion dollars in profits offshore. Which are in tax shelter in order to avoid being taxed. Should the countries that allow this kind of tax evasion being punished for allowing these tax shelters? No, these countries aren't doing anything wrong necessarily, although there are some shady deals that go on behind the scenes. But rather the US could rather lower the corporate tax rate and encourage companies to bring their profits back the US. Now, the US will never be able to compete with the little to no taxes that countries like Panama and the Netherlands have to offer, but at least be able to slightly cu the tax rate. With the new tax laws, corporations are already bringing in the capital held overseas and giving it back to the community. The community being their employees. Which has increased employee satisfaction and increased the publics perspective of the corporations

Will there ever be a perfect solution to tax shelters of course not, someone will always find a way to avoid tax, but there can be laws set in place that will be favorable for corporation, encouraging them to bring back their profits to the US.

Accounting 420: Case 10

By: Hunter Lawrence

April 4, 2018

State Street: Investments.

Executive Summary:

State Street Corporation provides investment management, trading and financial data analytics for potential investors. A couple things I have learned from this case are, first, the difference between the different kinds of debt and equity securities held on the balance sheet. With each security, there is are different ways to adjust the securities to their fair value. If a security is listed as “trading”, then the company should adjust the security to fair value after each accounting period, with the gains and losses in the fair value to flow through the income statement. If a security is listed as “available-for-sale”, then the company would also adjust the fair value of the security after each accounting period but the company would flow the gains and losses through other comprehensive income, which is listed in the equity section of the balance sheet. Finally if a company has a security listed as “held-to-maturity” then they amortize the cost over the life of the debt security. With a “held-to-maturity”, a company can only record a gain or loss on the security on the date it is sold. I also learned that with a financial company that is actively trading investment, on the Statement of Cash Flows they will not has “investing activities” listed. This due to the fact that investing activities is a part of the daily operations of the business. Therefore, it is listed under the revenue section of the income statement. This case provided a good basis for future dealing with financial institution similar to State Street. I am very interested in working for clients that are financial institutions. Hopefully, when in practice I will be able to apply my knowledge I learned while doing this case.

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

i. In general, what are trading securities?

Trading securities are classified as both debt and equity securities which a company intends to sell in the short term for a profit. Trading securities is done through the stock market to make profit in the current period. When a security is bought it is recorded on the company's balance sheet, as a current asset, at the fair value at the date of purchase. Since the stock price of the security is always changing company's may adjust the trading securities maintain these assets at fair market value. This unrealized holding gain or loss is adjusted in a temporary account at the end of each period, this account is named FV Adjustment. Any unrealized holding gain or loss is recorded through the income statement.

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

Account	Debit	Credit
Cash	1	
Dividend Revenue		1

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

Account	Debit	Credit
Fair Value Adj.	1	
Unrealized Holding Gain- Income		1

Since these are classified as trading securities, they flow through the income statement.

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

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

Available-sale-securities are classified as either debt or equity securities purchased by a company that intends to sell before it reaches maturity. When recorded on the company's balance sheet the company classifies them at the fair market value. When the fair value of the securities change from period to period they are adjusted against the operating income in the equity section of the balance sheet. They are also adjusted in an FV Adjustment account but flow through other comprehensive income account (OCI).

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

Account	Debit	Credit
Cash	$1	
Dividend Revenue		1

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

Account	Debit	Credit
Fair Value Adjustment	$1	
Unrealized Holding Gain- Equity		1

Since these are classified as an available-for-sale securities, they flow through other comprehensive income which is listed on the balance sheet.

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?

When a company decides to purchase a security held-to-maturity the company intends until the equity security all the way until its maturity date. Examples of securities held-to-maturity are corporate bonds or municipal bonds. This type of security is listed on the company's balance sheet listed at the stated price of the bond. These securities are usually sold at a discount or a premium. If this is the case then the discount or premium is amortized over the life of the bond. There are several different types of amortization methods. The most common methods of amortization are effective interest method or straight line method. Unlike available-for-sale or trading securities, when the fair value of the security changes price over the course of the accounting period there is no adjustment to fair value of the security. Gains and losses are only realized when the bond is sold.

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

Since these are listed as held-to-maturity, there is no entry made to adjust the securities to fair value.

If the security was originally record at a discount.

Cash	xx	
Debt Security		xx
Interest Revenue		xx

If the security was originally recorded at a premium

Cash	xx	
Debt Security		xx
Interest Revenue		xx

If the security was recorded at par value

Cash	xx	
Interest Revenue		xx

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?

Listed on the balance sheet of State Street for the in the Trading account assets is $637,000,000.

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.

	Debit	Credit
Fair Value Adjustment	85	
Unrealized Holding Gain- Income		85
($ millions)		

This journal entry is reflected as a gain listed in the income statement.

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?

Listed on the company's balance sheet for Investment securities Held to Maturity is 11,379 ($ millions)

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

The market value currently for the Investment Securities Held-to-maturity are currently listed at 11,661. A possible reason for an increase in the fair value of the bonds is a decrease in interest rates.

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?

Amortized cost is an amortization of a company's asset that is written off over the life of the asset. It represents an accumulated amortization to the maturity date of the asset. There are different methods to amortize an

asset. Effective interest method or the straight-line method are the two most common ways to amortize an asset.

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?**

In order to calculate the carrying value of the bond at the current date, the company will either take the original cost and add amortization cost (discount), or take original cost and subtract amortization cost (premium). The difference between the market value of the security and the carrying value to date is either the gain or loss on the sale of the security. The market value of the security is dependent on several factors. The current interest rates at the time, the credit of the company taking out the loan, or the financial positon of the company at the time of the loan are several factors in calculating the market value of the bond.

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?**

On State Street's balance sheet, Investment Securities Available-for-sale is listed at 109,682.
($ millions)

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.**

Investment- AFS 1,119
Unrealized Holding Gain
1,119
($ millions)

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?**

There is no Statement of Cash Flows associated with financial institutions.

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):

i. **Show the journal entry State Street made to record the purchase of available-for-sale securities for 2012.**

	Debit	Credit
Investments	60,812	
Cash		60,812
($ millions)		

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.**

	Debit	Credit
Cash	5,399	
Unrealized Holding Gain- Equity	69	
Investment		5,411
Realized Gain on Sale		55

iii. Use the information in part *g. ii* to determine the original cost of the available-for-sale securities sold during 2012. Use Note 4 and your solution to part *g. ii*, to determine the amount of net unrealized gains (losses) during 2012 for the available-for-sale securities *on hand* at December 31, 2012. Show the journal entry that State Street would have made to mark the available-for-sale securities portfolio to market value at year end. How would this amount impact State Street's statement of cash flows for 2012? Ignore any tax considerations for this analysis. *Hint:* use a T-account to analyze the changes in the net unrealized gains (losses) activity in Note 4.

State Street is a financial institution; they are actively involved in the buying and selling of securities. Any investment in a security is a part of their daily business operations. So, there is no need for an investments section on the Statement of Cash. The investments are considered revenue and flow through the Income Statement of the company.

Accounting 420: Case 11

By: Hunter Lawrence

April 11, 2018

ZAGG Inc.: Deferred Income Taxes

Executive summary:

This case pertained to the deferred income taxes of ZAGG, Inc. Using ZAGG's different financial statements we interpreted the deferred tax liabilities and deferred tax assets, and how they are journalized. We also found the difference in the statutory rate and effective rate and what makes them different. The difference in taxable income and pre-tax income also plays a large factor in the overall presentation of a company. Externally a company can look different than it is on the inside depending on how the information is interpreted. One of the main things that I got from this case is the fact that deferred tax assets (DTAs) can never become deferred tax liabilities (DTLs). Once the deferral comes to maturation, it disappears and does not go back into the opposite account.

I learned the most about how temporary differences have a different effect of taxes than permanent differences. Temporary differences stem from differing views on when revenues or expenses are recognized, and in turn, effect when the tax is recognized on those revenues and expenses.

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 defined as the income from specific items that are reported on the company's income statement that are not a part of the company's taxable income. A couple of examples non-taxable items that a company might incur are municipal bonds, workers compensation, and tax refunds. ZAGG Inc. list for year ending 2012 $23,898 as income before taxes.

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

i. Permanent tax differences (also provide an example)

A permanent tax difference is a related business transaction that is reported differently by the company for financial reporting and tax reporting purposes, for which the difference between will never be eliminated. A permanent difference results in the elimination of a tax liability, which the company desires in order to pay less tax to the federal government. These permanent differences are the result of careful tax planning by accountants for the company. Examples of permanent differences are meals and entertainment expenses, municipal bond interest, and fines and penalties assessed by the federal government.

ii. Temporary tax difference (also provide an example)

Temporary tax differences is the difference between the carrying value of an asset or liability in the balance sheet and its tax base. The temporary difference reported by the company is settles when the carrying amount of the asset or liability is recovered or settled. Because of the differences, the expense that a company occurs during the accounting period usually affects both the current tax expense or income reported by the company, and the deferred tax expense or income. A couple types of temporary differences are deductible differences and taxable differences.

iii. Statutory tax rate

Statutory tax rate is the tax rate that is specified by the law. Examples of statutory tax rates are individual or corporate tax rates. Statutory tax rates vary by the amount of taxable income which either the individual or the corporation declares on their tax return.

iv. Effective tax rate

The effective tax rate is the average rate at which an individual or corporation is taxed. The effective tax rate for individuals is the average rate at which their income is taxed. For corporations, the effective tax rate is calculated as the average rate at which the corporation's pre-tax profits are taxed.

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?

The amount a company owes for deferred tax income is considered a part on the total income tax expense for the year. The company when then report this expense in an account titled "income tax expense", which is debited. The reason why it is debited is because the deferred tax income expense is treated like any other expense. There are two different types of deferred income taxes that occur due to normal business operation of the company. These are two types of deferred income taxes are deferred tax asset and deferred tax liability. Now later on in the case these will be defined thoroughly for the current moment, a deferred tax asset has a normal debit balance, while a deferred tax liability has a normal credit balance. It has proven difficult for companies to abide to the strict rules that are associate with ASC 740. ASC 740 was put in place in order to more clearly reflect the after-tax financial positon of a company in its balance sheet. More specifically the deferred tax assets or deferred tax liabilities accounts in the balance sheet. The two primary objectives of ASC 740 is to provide guidance for companies "to recognize the amount of taxes payable or refundable for the current year" and "to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns." This is significantly different to the old guidance on income taxes

which was just based on the matching principal, with no consideration of the timing differences associated with the deferred tax income. These differences are what result in a deferred tax asset and a deferred liability. An asset is record for situations when that will result in a future tax deductions. A liability is recorded when a company will have to include future taxable income on the companies tax return for the year.

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 tax asset represents the increase in taxes refundable in the future years as the result of deductible temporary differences existing at the end of the current year. An example of a deferred tax asset is if a business incurs a loss in the current financial year, it is usually entitled to use that loss in order to lower the corporation's taxable income in the following years. Whereas a deferred tax liability represents the increase in taxes payable in the future years as a result of taxable temporary differences existing at the end of the accounting period. An example of a deferred tax liability is the difference in depreciation expense treatment by tax laws and accounting rules.

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

Due to temporary differences and carryforwards associate with deferred tax assets and liabilities, companies must create a calculation account for the deferred tax asset. When there are any changes during the accounting period, the company should report any changes to the allowance within the income from continuing operations on the income statement. Sometimes, when tax laws change the company will have to alter the allowance account to reflect the proper number for reporting purposes.

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	
Deferred Tax Asset	8,293	
Income Tax Payable		17,686

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.

Income Tax Expense	$9,393
Deferred Tax Asset	8,002
Deferred Tax Liability	291
Interest Payable	

17,686

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.

In order to calculate the effective tax rate for the corporation, must take Income Tax Provision divided by the Income before provision for Income Taxes.

$9,393/ 23,898 = 39.30%

The corporate tax rate in America is roughly around 35%. The difference between the corporate tax rate and the effective tax rate incurred by ZAGG Inc. is accounted for in the allowance of deferred income tax benefit or provisions.

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 amount of 13,508 is calculated by adding deferred income tax assets of 6,912 and 6,596.

Accounting 420: Case 12

By: Hunter Lawrence

April 30, 2018

Apple Inc.: Revenue Recognition

Executive Summary:

This case is all about the new Revenue recognition standard, which FASB issued in 2015. But just came into effect in the 2018 reporting year. This case will be highly useful when entering the business environment. Past student have learned how to report under the old standard but having knowledge about the new revenue recognition could but me a head of the game and allow me to stand out. The reason why FASB issued this new standard is to provide more clear guidance on reporting revenue to increase comparability and consistency across all industries. This will allow potential investors and creditors alike to more easily decipher the financial statements of the reporting company. I learn about the process by which Apple reports according to the five criteria that is listed by FASB. Apple usually recognizes revenue when the shipment is received by the purchaser. In special case, like third party seller in India, Apple reports revenue when it is shipped, leaving the buyer with the risk of shipping. A couple things I found interesting about this case was the way that Apple deals with gift cards. When a gift card is purchased the revenue is deferred, which makes sense. But I would assume the revenue would be recognized when a purchase was made with the gift card on the iTunes store. However, the revenue is actually recognized when the gift card is redeemed. Second thing I found interesting, was when researching about India and its third party iPhone sellers that India is a huge market that Apple is trying to pursue heavily. India is largely untapped and if Apple is able to control the market in India its revenue will dramatically increase. This case has provided a good basis about revenue recognition and will hopefully give me the knowledge to perform well on the job in a couple of years.

A. **<u>In your own words, define “revenues.” Explain how revenues are different from “gains.”</u>**

Revenue for a company is defined as the sale of goods or services provided by the company that are associated with the main operations of the company. When presented in the income statement, revenue is usually listed as the first line item in the income statement. To get to net income the most basic calculation is revenues minus any expenses equal net income. But there is a difference between revenue and gains associated with a company. Revenue occur in the normal operations of the business whereas a gain is the result of a transaction not associated with the company’s primary operations of business. For example a company like apple who’s main operations is producing tech products, they sell a truck for $10,000 which had an adjusted basis of $5,000, and Apple Inc. would report a gain of $5,000. This is due to the fact that Apple doesn’t normally sell trucks as a part of their normal business operations. Any time a company produces profit or realizes increased value through secondary sources, the reporting company would report a gain.

B. **<u>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.</u>**

The new standard about revenue recognition, ASC 606, is going to significantly affect the revenue recognition practices of most reporting companies. The purpose of the new standard is to improve the concept of comparability across companies. Most revenue transactions pose few problems for revenue recognition, but there are a few situations in which the new standard was needed to provide guidance. A company recognizes revenue when a specific event that is measureable, whether be a service provided or the sale of a good that results in a transaction. When a revenue transitions occurs it will be reported on the income statement, which stated earlier is most likely the first line item on the income statement. Sometimes when a company provides a service for a company but doesn’t get paid on the date when the service was provided, this is an example when a company that provided the service will report revenues and at the same time will increase their accounts receivable. Accounts receivable is a balance sheet account.

C. <u>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?</u>

There are five criteria to revenue recognition. The first is to identify the contract with customers. The second is to identify the spate performance obligation that is stated in the contract. The third is to determine the truncation price listed within the contract. The fourth is to allocate the transaction price to the separate performance obligations. Lastly, is to recognize revenue when each performance obligation is satisfied. Apple Inc. reports revenue "when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determined and collection is probable." This is fairly similar to the criteria required for revenue recognition. A couple of different examples of when Apple recognizes revenue. One, when the product is sold in store revenue is recognized as soon as the product is sold. Second, when an online purchase is made Apple defers revenue until the customer receives the product. Lastly, when Apple receives payment in advance of the delivery of products the company defers revenue until the goods arrive and the performance obligations is satisfied.

D. <u>What are multiple-element contracts and why do they pose revenue recognition problems for companies?</u>

A multiple-element contract is where a company sells multiple products to a single customer under a single contractual agreement. The problem that comes with multiple-element contracts is under the accrual method of accounting is, how should revenue be reported and measured to each component or product involved in the sale? Since the company is providing goods and services over time it is difficult to allocate properly the right amount to each good over the same period of time. The old standard lacked consistency and comparability between companies. With the new standard off multiple-element contracts, it will provide a clearer understanding of the economic realities of the arrangements, and will show a better picture of the way the company is reporting revenues over time. For Apple Inc. they deal with multiple-element contracts by, "the company allocates revenue to all deliverables based on their relative selling prices." This is in line with the new standard and is the most

common process of allocating revenue by companies with multiple-element contracts.

E. **<u>In general, what incentives do managers have to make self-serving revenue recognition choices?</u>**

When it comes to earnings management, mangers are faced with the tough choice on how they will report the revenue for the year. There are outside forces that influence mangers to always report higher revenue and outside income in order to meet quarterly expectations. Usually the investors of the company and the Board of Directors would want a higher than expectations result because the stock price will tend to increase, in turn increasing their own wealth. At the same time there are tax consequences that come along with reporting higher net income. The company will be subject to higher taxes when there is a high taxable income. This is the constant struggle that mangers are faced with.

F. **<u>Refer to Apple's revenue recognition footnote. In particular, when does the company recognize revenue for the following types of sales?</u>**

i. **iTunes songs sold online.**

ITunes is a music platform created by Apple where it allows customers the ability to purchase their favorite music. ITunes does not own any of the content that is posted on iTunes besides a couple apps Apple internally has developed. ITunes reports revenue on the commission on the songs that are purchased. The rest of the revenue will be reported by the artist or the company of which the customer purchased.

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

If the products are bought in the apple store then the revenue would be recognized at the time of the sale. That means as soon as the transaction is complete and there is transfer of ownership Apple should record revenue.

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

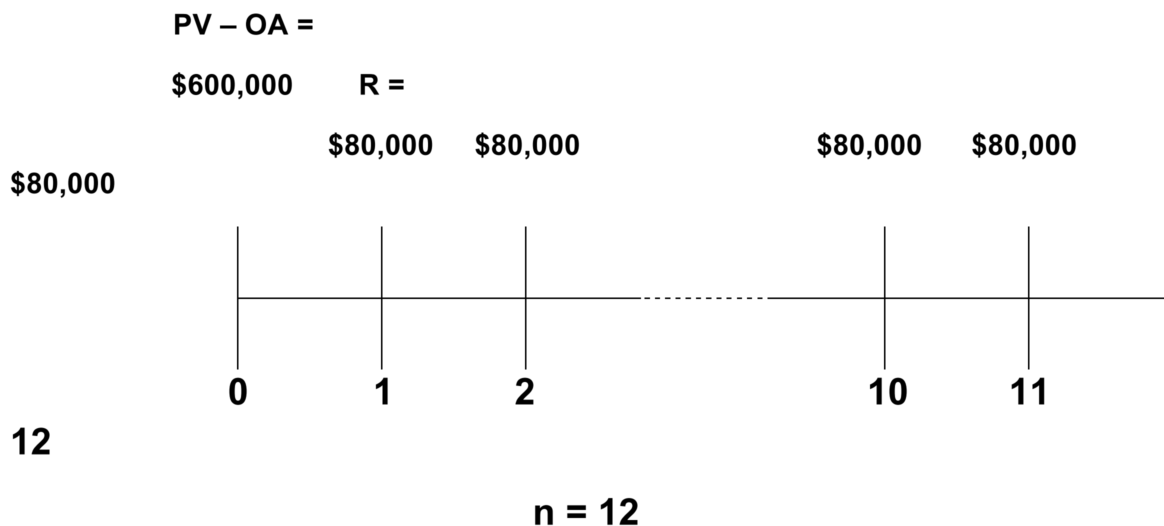
As Apple is trying to increase its market share one of the most untapped markets is India. India has the second highest population for a country yet still hasn't caught onto the tech industry. Many parts of India still reflect parts of third world counties. The new president of India has made it a goal to install new LTE capabilities for the country, this was highly praise by CEO of Apple Tim Cook. Apple now is able to sale their IPhones in India which rely on LTE to stream content. This new LTE networks is going to increase sales exponentially in India for Apple and they may become the dominant phone in India. Apple recognizes revenue to third party sellers in India when the product ships, this is slightly different than originally stated. In this situation the buyer assumes the risk that come with shipping.

iv. Revenue Recognition on Gift Cards.

When a gift card is purchased whether at a grocery store or at the apple store the revenue is deferred. It is not until the gift card is redeemed by the customer on the iTunes store that Apple recognizes revenue.

So, in part in A of problem 6-7 we are trying to find the annual interest rate for the entire investment of the company.

In scenario one of the problem we are given the present value of $600,000, the initial payment of $80,000 and over a 12 year period. So we first establish a time to visually show us the process of finding the interest payment.



Then we set up the formula like this,

Formulas: $PV - OA = R\ (PVF - OA_{n,\ i})$

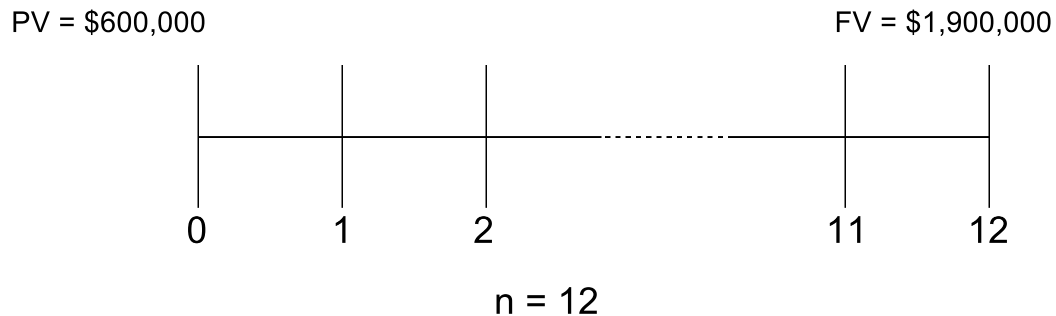
$\$600{,}000 = \$80{,}000\ (PVF - OA_{12,\ i})$

$PVF - OA_{12,\ i} = \$600{,}000 \div \$80{,}000$

$PVF - OA_{12,\ i} = \underline{\underline{7.50}}$

We use the present value because the value is given to us in the problem. The reason we are using the present value of an ordinary annuity because the payment are due at the end of the period. We then divide the present value of the ordinary annuity by the annual payment for the annuity. This gives us a value of 7,50, which is the approximate value of an ordinary annuity for 12 years discounted at approximately 8%.

In scenario, two of the problem we are given a future value $1,900,000 as well the previous givens in the problem. We first establish a time line for the problem.



Then we set up the formula like this,

$FV = PV\ (FVF_{n,\,i})$

$\$1{,}900{,}000 = \$600{,}000\ (FVF_{12,\,i})$

$FVF_{12,\,I} = \$1{,}900{,}000 \div \$600{,}000$

$FVF_{12,\,I} = \underline{\underline{3.16667}}$

We use the future value because we are given the future value of the problem. We are using the future value of a single sum as well because it is the lump sum method. We then divide the future value by the present value sum, which gives a value of 3.16667. This value of 3.16667 is the approximate future value for 12 years at 10%.

Appendix

Appendix A- Eads Home Heaters, Inc.

a.

Eads Home Heaters, Inc.

Adjusted Trail Balance: As of December 31, 20X1

	Debit	Credit
Cash	$ 7,835.00	
Accounts Receivables	$ 99,400.00	
Allowance for Doubtful Accounts		$ 4,970.00
Inventory	$ 51,000.00	
Land	$ 70,000.00	
Building	$ 350,000.00	
Accumulated Depreciation- Building		$ 10,000.00
Equipment	$ 80,000.00	
Accumulated Depreciation- Equipment		$ 20,000.00
Leased Equipment	$ 92,000.00	
Accumulated depreciation- Leased Equipment		$ 11,500.00
Note Payable		$ 380,000.00
Accounts Payable		$ 26,440.00
Interest Payable		$ 6,650.00
Lease Payable		$ 83,360.00
Common Stock		$ 160,000.00
Dividends	$ 23,200.00	
Sales		$ 398,500.00
Cost of goods sold	$ 188,800.00	
Other Operating Expenses	$ 34,200.00	
Bad Debt Expense	$ 4,970.00	
Depreciation Expense- Building	$ 10,000.00	
Depreciation Expense- Equipment	$ 20,000.00	
Depreciation Expense- Leased Equipment	$ 11,500.00	
Interest Expense	$ 35,010.00	
Provision for Income Tax	$ 23,505.00	
Total	$1,101,420.00	$1,101,420.00

b.

Eads Heating, Inc.
Part B: Recording Additional Information

	Assets										
Transactions	Cash	Account receivables	Allowance for Bad Debits	Inventory	Land	Buildings	Accumulated Deperciation Building	Equipment	Accumulated deperciation equipment	Leased Equipment	Accumulated Depreciation Leased Equipment
Balances: Part A	$ 47,340.00	$ 99,400.00		$ 239,800.00	$ 70,000.00	$ 350,000.00		$ 80,000.00			
Part B(1) Bad debts			$ 4,970.00								
Part B(2) COGS				$ (188,800.00)							
Part B(3) Depreciation											
Buildings							$ 10,000.00				
Equipment									$ 20,000.00		
Part B(4) Equipment											
Lease										$ 92,000.00	
Lease Payment	$ (16,000.00)										
Depreciation											$ 11,500.00
Part B(5) Income tax	$ (23,505.00)										
Balance Part(B)	$ 7,835.00	$ 99,400.00	$ 4,970.00	$ 51,000.00	$ 70,000.00	$ 350,000.00	$ 10,000.00	$ 80,000.00	$ 20,000.00	$ 92,000.00	$ 11,500.00

	Liabilities				Stockholders Equity										
Transactions	Accounts Payable	Interest Payable	Lease Payable	Note Payable	Common Stock	Dividends	Sales	Cost of Goods Sold	Depreciation Expense Building	Depreciation Expense Equipment	Depreciation Expense Leased Equipment	Bad Debt Expense	Other Operating Expenses	Rent expense	Income Tax
Balances: Part A	$ 26,440.00	$ 6,650.00		$ 380,000.00	$ 160,000.00	$ 23,200.00	$ 398,500.00						$ 34,200.00		
Part B(1) Bad debts												$ 4,970.00			
Part B(2) COGS								$ 188,800.00							
Part B(3) Depreciation									$ 10,000.00						
Buildings															
Equipment										$ 20,000.00					
Part B(4) Equipment															
Lease															
Lease Payment			$ 92,000.00												
Depreciation			$ (8,640.00)								$ 11,500.00				
Part B(5) Income tax															$ 23,505.00
Balance Part(B)	$ 26,440.00	$ 6,550.00	$ 83,360.00	$ 380,000.00	$ 160,000.00	$ 23,200.00	$ 398,500.00	$ 188,800.00	$ 10,000.00	$ 20,000.00	$ 11,500.00	$ 4,970.00	$ 34,200.00	$ -	$ 23,505.00

Appendix B- Glenwood Home Heaters, Inc.

a.

Glenwood Home Heaters, Inc.

Adjusted Trail Balance: As of December 31, 20X1

	Debit	Credit
Cash	$ 426.00	
Accounts Receivables	$ 99,400.00	
Allowance for Doubtful Accounts		$ 994.00
Inventory	$ 62,800.00	
Land	$ 70,000.00	
Building	$350,000.00	
Accumulated Depreciation- Building		$ 10,000.00
Equipment	$ 80,000.00	
Accumulated Depreciation- Equipment		$ 9,000.00
Accounts Payable		$ 26,440.00
Note Payable		$380,000.00
Interest Payable		$ 6,650.00
Common Stock		$160,000.00
Dividends	$ 23,200.00	
Sales		$398,500.00
Cost of goods sold	$177,000.00	
Other Operating Expenses	$ 34,200.00	
Bad Debt Expense	$ 994.00	
Depreciation Expense- Building	$ 10,000.00	
Depreciation Expense- Equipment	$ 9,000.00	
Rent Expense	$ 16,000.00	
Interest Expense	$ 27,650.00	
Provision for Income Tax	$ 30,914.00	
Total	$991,584.00	$991,584.00

b.

Eads Heating, Inc.

Part B: Recording Additional Information

	Assets									Liabilities	
Transactions	Cash	Account receivables	Allowance for Bad Debits	Inventory	Land	Buildings	Accumulated Deperciation Building	Equipment	Accumulated Deperciation Equipment	Accounts Payable	Interest Payable
Balances: Part A	$ 47,340.00	$ 99,400.00		$ 239,800.00	$ 70,000.00	$ 350,000.00		$ 80,000.00		$ 26,440.00	$ 6,650.00
Part B(1) Bad debts			$ 994.00								
Part B(2) COGS				$ 177,000.00							
Part B(3) Depreciation											
Buildings							$ 10,000.00				
Equipment									$ 9,000.00		
Part B(3) Depreciation											
Building											
Equipment											
Part B(4)	$ (16,000.00)										
Part B(5) Income tax	$ (23,505.00)										
Balance Part(B)	$ 426.00	$ 99,400.00	$ 994.00	$ 62,800.00	$ 70,000.00	$ 350,000.00	$ 10,000.00	$ 80,000.00	$ 9,000.00	$ 26,440.00	$ 6,550.00

	Liabilities	Stockholders Equity									
Transactions	Note Payable	Common Stock	Dividends	Sales	Cost of Goods Sold	Depreciation Expense Building	Depreciation Expense Equipment	Bad Debt Expense	Other Operating Expenses	Rent expense	Income Tax
Balances: Part A	$ 380,000.00	$ 160,000.00	$ 23,200.00	$ 398,500.00					$ 34,200.00		
Part B(1) Bad debts								$ 994.00			
Part B(2) COGS					$ 177,000.00						
Part B(3) Depreciation						$ 10,000.00					
Buildings											
Equipment							$ 9,000.00				
Part B(3) Depreciation											
Building											
Equipment											
Part B(4)										$ 16,000.00	
Part B(5) Income tax											$ 23,505.00
Balance Part(B)	$ 380,000.00	$ 160,000.00	$ 23,200.00	$ 398,500.00	$ 177,000.00	$ 10,000.00	$ 9,000.00	$ 4,970.00	$ 34,200.00	$ 16,000.00	$ 23,505.00

Appendix C- Home Heaters Inc. Calculations of EPS

EPS= (Net Income – Dividends)/ Average Share of Common Stock Outstanding

Glenwood EPS= ($92,742 - $23,200)/ 3,200

EPS= $21.73 per share

Eads EPS= ($70,515-$23,200)/ 3200

EPS= $14.79 per share

Appendix D- Molson Coors Brewing

Net income compared to comprehensive income

Net income divided by comprehensive income

$567,300,000/ $760,200,000 = .7443= 74.43%

Appendix E- Pearson Plc

This is the T-account for Provision for Doubtful Debts. (In millions)

Provision for Bad and Doubtful Debts

Debit	Credit
	72 (2009 Beginning Balance)
5 (Exchanges)	
20 (utilized)	26 (Income Statement)
	3 (Business Acquisitions)
	76 (2009 Ending Balance)

Appendix F- Pearson Plc

These are the journal entries for provision for doubtful debts. (In millions)

Account	Debit	Credit
Bad Debt Expense	26	
Provision for Bad Debts		26
Provision for Bad Debts	20	
Account Rec.		20

Appendix G- Pearson Plc

This is the T-account for Provision of Sales Returns. (In millions)

Provisions for Sales Returns

Debit	Credit
	372 (2009 Beginning Balance)
	425 (Estimate of Returns)
443 (Actual Returns)	
	354 (2009 Ending Balance)

Appendix H- Pearson Plc

These are the journal entries for Provisions Sales Returns. (In Millions)

Cash

Appendix I- Pearson Plc

This is both the journal entries and T-account for Trade Receivables of the years. (In millions)

Trade Receivables (gross)	
1,030 (2009 Beginning Balance)	
5,624 (Credit Sales)	
	5202 (Cash Collections)
	20 (Write-Offs)
	443 (Sales Returns)
989 (2009 Ending Balance)	

Account			
Accounts Receivable	5,624		
Sales		5,624	
Cash	5,202		
Account Receivable			5,202
Provision for Bad and Doubtful Debts		20	
Account Receivable			20
Provision for Returns and Allowances		433	
Account Receivables			433

Appendix J- Palfinger Corporation

Journal entry

Account	Debit	Credit
Cash	1,655	
Accumulated Deprecation	6,235	
Equipment (Disposal)		6,820
Gain on sale of Equipment		1,070

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