Accounting Research and Professional Development

Ragan Riley

ACCOUNTING RESEARCH AND PROFESSIONAL DEVELOPMENT

by Ragan Riley

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

Oxford, MS
May 2020

Approved by

Victoria Dickinson

Advisor: Dr. Victoria Dickinson

W. Mark Wilder

Reader: Dean Mark Wilder

ABSTRACT

RAGAN RILEY: Accounting Research and Professional Development
(Under the direction of Dr. Victoria Dickinson)

This paper is a compilation of various accounting studies assigned by Dr. Victoria Dickinson throughout a yearlong professional development course for accounting. During each of the twelve cases, the student was required to identify accounting principle problems within the cases, research proper accounting practices, and critically think through how these situations should have been handled in order for these companies to be in accordance with GAAP. There were also cases that facilitated decision making for students in their future career such as location decisions and articles regarding current accounting problems. This course allowed students to network with peers and accounting professionals, research and apply real life skills that will be beneficial for our upcoming internships and allowed the student to learn how to work through problems that may arise on the job.

TABLE OF CONTENTS

LIST OF FIGURES

CASE STUDY ONE: Data Analytics

CASE STUDY ONE: Data Analytics

In this case study, students were asked to research their assigned data and analytics tool and understand the purpose of the tool, understand how to use the tool in various business settings, and compile a few paragraphs to a future public accounting partner explaining why the company should implement the tool. I was assigned SAS. SAS is a tool that many companies use that provides a vast variety of solutions to difficult decisions, helps forecast the future, and reduces the manual workload. Companies can also use this tool to target new markets, improve customer service and offer more personalized products.

Accounting has evolved so much with the new age of technology. Everything is becoming more automated. With programs like SAS, accountants are able to perform audit checks with the click of a few buttons, which can free up time, making the entire auditing process more efficient. The tool is also beneficial to businesses that want to look into the future for the company with SAS's forecasting capabilities. Overall, SAS is a tool that can be used in numerous ways to help not only the accounting field, but also businesses seeking information about their future. This tool will be very important, and I can expect to learn about it and someday use it in my future.

SAS

SAS is a tool that can be used for a variety of business applications. Many companies use SAS ranging from American Honda Motor Company, Inc. to Discover Financial Services. In a world where "big data" has begun to take over, a tool like SAS is extremely beneficial. With the application of SAS, companies can mine data to show only information that is relevant, use multivariable approaches while examining possible outcomes, and help forecast for the future. All of these tools help give SAS equipped companies a competitive advantage over their competitors. Take the system into perspective. When faced with a tough business decision, would you rather go through loads of data to make one decision when you could potentially make the wrong one, or would you prefer a tool like SAS to mine data, give insights, forecast, and even manage data for you all with the click of a button? SAS is a tool that any company can get on board with. It has a variety of resources and functions that make life for the company and its employees easier.

Auditing

- When performing an audit, it is impossible to be able to analyze every business process a company performs. With the data mining function of SAS, auditors could establish the information they deemed relevant. Then, they can let SAS compile a report with the specific information the auditor is looking for. This feature is also useful in detecting patterns and uncovering fraud, which is a major advantage for auditors.
- The predictive analysis tool that SAS possesses can help companies predict bad debt expense by analyzing accounts receivable. This feature can also aid in predicting unanticipated inventory expenses such as defects in inventory and unused inventory based on past information.
- SAS can also use the predictive analysis tool to help a company predict future resources. For example, if toy sales are expected to rise around the Christmas holidays, companies may need to hire more workers or add more inventory to stay

up to par with the increase in sales. SAS helps companies make these predictions and pinpoint exactly how many resources the company will need.

Tax Planning

- SAS can be used for tax planning in a multitude of ways. One of the most important features regarding tax planning is SAS's ability to run regression analysis on large amounts of data. Think of all the variables that are computed in tax planning. Instead of hours and hours of changing variables and researching previous rates, this SAS function can do virtually all of that with the click of a button.
- Predictive analysis is also an important function for tax planning. If a company wants to expand its business globally, it must consider many risks and variables. With this function of SAS, companies can see if the expansion will be feasible, what the tax rates would look like, and determine whether the market is projected to grow in this region.
- The in-memory analytics function that is a part of SAS would completely revamp the system in place for determining the most efficient taxable income for a company. This function can run a multitude of scenarios to help find a company's "best fit" for their taxable income.

Dear Future Partner:

I believe SAS would be an excellent tool for our company. With its abilities to run multivariable analysis, predict and forecast pretty much anything you can dream up, and detect fraud by mining through data, SAS proves to be one of the most efficient and effective business tools that is around today. Not only is the tool used for accounting purposes, it is also beneficial in a variety of other departments. It covers everyday systems used in both tax planning and auditing.

Employees would no longer spend hours and hours collecting data then compiling it into information that can be interpreted in various ways by many channels. With SAS, data is mined to reflect only the most relevant information. The information can then by composed into graphs, charts, and future projections, as well as, tools like regression analysis and feasibility analysis all within a moment's time. Our employees will be better equipped to find solutions to difficult decisions and analyze large amounts of data efficiently. SAS would be a wonderful asset for our company to acquire, especially, in the era of "big data" and technology advancing into worlds unknown.

Sincerely,

Ragan Riley

Ragan Riley

CASE STUDY TWO: Rocky Mountain Chocolate Factory, Inc. Financial Statements

CASE STUDY TWO: Rocky Mountain Chocolate Factory, Inc. Financial Statements

This case was designed to walk through Rocky Mountain Chocolate Factory's accounting cycle. We began with journal entries, which revealed the balances for our accounts that helped us prepare an unadjusted trial balance. From there, we were able to adjust our entries as needed in order to create an adjusted trial balance. The adjusted trial balance helped prepare the financial statements for Rocky Mountain Chocolate Factory, Inc. After reviewing our statements and assessing our journal entries, we were finally able to determine where the journal entries fit into a cash flows statement. Throughout this study, I was able to see first-hand how each financial statement is linked to one another, and I learned how to prepare these statements for a company through the use of Excel.

With manufacturing companies such as Rocky Mountain Chocolate Factory, Inc., we should expect to see cash, accounts receivable, inventories, and property and equipment serving as the company’s assets on the balance sheet. For liabilities, accounts payable, accrued salaries and wages, and accrued expenses are all common accounts that are shown on a balance sheet for a company like Rocky Mountain Chocolate Factory, Inc.

Figure 2-1: Rocky Mountain Chocolate Factory, Inc. Trial Balance

Rocky Mountain Chocolate Factory, Inc.
Unadjusted Trial Balance

Accounts	Debit	Credit
Cash and cash equivalents	$3,743,092	
Accounts receivable	4,427,526	
Notes receivable, current	91,059	
Inventories	3,498,283	
Deferred income taxes	461,249	
Other current assets	220,163	
Property and Equipment, Net	5,885,289	
Notes receivable, less current portion	263,650	
Goodwill, net	1,046,944	
Intangible assets, net	110,025	
Other long-term assets	88,050	
Accounts payable		877,832
Other accrued expenses		946,528
Dividend payable		602,694
Deferred income		220,938
Deferred income taxes		894,429
Common stock		180,808
Additional paid-in capital		7,626,602
Retained earnings		3,343,850
Sales		22,944,017
Franchise and royalty fees		5,492,531
Cost of sales	14,693,786	
Franchise cost	1,499,477	
Sales & marketing	1,505,431	
General and administrative	1,782,947	
Retail operating	1,750,000	
Interest income		27,210
Income tax expense	2,090,468	
Total	**$ 43,157,439**	**43,157,439**

Figure 2-2: Rocky Mountain Chocolate Factory, Inc. Income Statement

Rocky Mountain Chocolate Factory, Inc.
Income Statement
For the Year Ended February 28, 2010

Revenues	
Sales	$22,944,017
Franchise and Royalty Fees	5,492,531
Total Revenues	28,436,548
Cost and Expenses	
Cost of Sales	14,910,622
Operating Expenses	
Selling Expenses	
Sales and Marketing Expenses	1,505,431
Retail Operating Expenses	1,756,956
Administrative Expenses	
General and Administrative Expenses	2,422,147
Franchise Costs	1,499,477
Depreciation and Amortization	698,580
Total costs and expenses	22,793,213
Operating Income	5,643,335
Other Revenues and Gains	
Interest Income	27,210
Income Before Tax	5,670,545
Income Tax Expense	2,090,468
Net Income	$3,580,077

Figure 2-3: Rocky Mountain Chocolate Factory, Inc. Balance Sheet

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

Assets		
Current Assets		
Cash and cash equivalents	$3,743,092	
Accounts receivable	4,427,526	
Notes receivable, current	91,059	
Inventories	3,281,447	
Deferred income taxes	461,249	
Other	220,163	
Total current assets		$12,224,536
Long Term Assets		
Property and Equipment, Net	5,186,709	
Notes receivable, less current portion	263,650	
Goodwill, net	1,046,944	
Intangible assets, net	110,025	
Other	88,050	
Total Assets (Long Term)		$6,695,378
Total Assets		$18,919,914
Liabilities and Stockholders' Equity		
Liabilities		
Current Liabilities		
Accounts payable	877,832	
Accrued salaries and wages	646,156	
Other accrued expenses	946,528	
Dividend payable	602,694	
Deferred income	220,938	
Total Current Liabilities		$3,294,148
Deferred income taxes		894,429
Stockholder's Equity		
Common stock	180,808	
Additional paid-in capital	7,626,602	
Retained earnings	6,923,927	
Total Stockholder's Equity		$14,731,337
Total Liabilities and Stockholder's Equity		$18,919,914

CASE STUDY THREE: Accounting Scenarios

CASE STUDY THREE: Accounting Scenarios

This case study was designed to help students think through different scenarios to help determine how they felt about each situation. Students watched as different scenes were acted out, then the student evaluated which character they emphasized with most in the scenario. We were then instructed to pick one side of the room determined by which option you agreed with. Students then had to defend their opinion by explaining their thought process to the class, while hoping to sway others to understand their views. Each side of the classroom gave their defense and explained why or why not they agreed with the scenario. This turned out to be a beneficial activity and influenced students to begin thinking about these scenarios in their own life.

This case showed me how different similar people can be. Although all of the students in the classroom were accounting majors and had similar career goals, each person had their own opinion of how certain scenarios should be handled. It was interesting to hear how other students backed up their opinions with different experiences and facts.

Scenario One:

As you were studying, you overhear a conversation between two fellow classmates. One of your classmates says that he wants to go to law school in New York because his cousin says that he will make more money as a tax accountant if he goes to law school instead of staying at Ole Miss and earning his Master of Taxation through the Patterson School of Accountancy. How do you feel about this statement?

⇒ Personally, I feel that if the student already knows he wants to go to law school for tax accounting, then he should do what makes him happy. At the same time, if the student knows that is the path he wants to pursue, then he should look for an internship at a law firm and not at a public accounting firm, even though it could be a little more challenging to find an internship at a law firm. We discussed in class how firms are getting aggravated at the fact that students from our school accept the internship through these firms with no intention to stay with the firm and "pay the firm back" for the training and knowledge the student gains through the internship. If the retention rate at these firms are low, the firms will stop coming to recruit from Ole Miss, which has an effect on students actually wanting to go into public accounting. To summarize, if you are a tax accountant and you plan to go to law school, go for it. Just remember that you represent the University of Mississippi as a whole when taking these internships with an accounting firm, so burning bridges with these firms has an effect on not just you, but the entire Patterson School of Accountancy as a whole.

Scenario Two:

A fellow classmate would like to do investment banking. Should she pursue her degree through the Patterson School of Accountancy and take an internship her Senior year? Should she change to a more general business degree?

⇒ I do not know a lot about investment banking. However, since it is a career that places a lot of emphasis on accounting, I feel that the classmate should stay in the Patterson School of Accountancy and take the internship her Senior year. Many firms are versatile and could even have opportunities with investment banking within their firm. The student may not be placed in an investment banking position during the internship, but if she proves to be a high performer, then opportunities might open for her in the future if she sticks with the firm. The reason why my answer differs from the former scenario is that at least with investment banking, she has a chance to continue working for the firm and not just leave and got to law school after the internship is over. Plus, accounting is a stepping stone for investment banking, so I feel that since there is not really a direct degree for investment banking at Ole Miss, she would benefit more from an accounting degree rather than a general business degree.

Scenario Three:

- **Part One and Two:**

A student is currently interning at a Big 4 accounting firm in Washington DC. He emails Dr. D for advice about transferring back to his hometown of Dallas. He still wants to work for the firm, but he wants to move back closer to his hometown in Dallas.

⇒ I feel that if you begin an internship with a firm, you should complete the internship with the firm. If you get somewhere and decide it is not for you, that is okay. People are not perfect, and they do not always make the best decisions for themselves. The student should finish out the internship in DC and confirm that it is really not somewhere he can live for two to three more years. If that is the case, he should be upfront with his superiors and let them know what is going on. It is better to be upfront earlier instead of springing a huge decision on them last minute. You never want to ruin your reputation with a firm. The DC office has already invested money and time into this student, so it is only fair that he stays with that office for his due time. After that period, if he still wants to transfer, the firm will be more willing to help him out since he was committed to them. It was okay to get advice from Dr. D, but at the end of the day, the student needs to have open communication between him and his superiors.

- **Part Three: continuation of part one and two**

⇒ At the end of the day, the firm does not want you there if you do not want to be there. If you are open with the firm and let them know your thoughts ahead of time, they are more willing to accommodate you. They are people too and they want what is best for you and for the firm. The key is open communication.

CASE STUDY FOUR: Accounting for Debt Securities Sales and Impairments

CASE STUDY FOUR: Accounting for Debt Securities Sales and Impairments

This case examines how a financial institution should apply new accounting rules regarding debt security impairments and determining whether or not the security is considered impaired in regard to ASC 326-30. After determining if the institution recorded their securities and losses properly, the student then takes on the role as both a bank executive and an external auditor to compare and contrast the differing opinions of each role. This task helps exhibit how different roles can call for different incentives. It also shows how sometimes financial information is buried in an institution's reports by the way it is recorded and who it is recorded by.

This case showed me how a company can report financial information not necessarily incorrect, but vague, in regard to the true intentions of what is really going on. It all depends on who is reporting the information when determining how to interpret what is being reported. Executives often blur the lines or try to make it seem as if what is really going on will not look as bad as it is whenever it is reported on the financial statements. Financial statements are used by investors and creditors to help make decisions about whether or not to do business with a company. Of course, company executives want these reports to be appealing, and as they try to portray an appealing statement, they may sometimes hide important information from the public.

It was interesting to take on the roles as both an external auditor and an executive for a company to determine what should be reported and how it should be reported. As an external auditor, you are focused on ensuring that information is correct and that it is reported in a fair and timely manner. As an executive, you want your financial statements to be appealing, as stated before. At the same time, you want to report accurate information to stay in compliance with updated accounting rules. This case was very interesting since we are being introduced to securities in our accounting class right now. We are able to get a better understanding of what a security is and how it is reported to help reinforce what we are learning in class.

Part One:

I believe that Generic Bank does have an impairment loss on the seven securities. If the securities were sold shortly after 2013, Generic Bank violated the intent to sell in 2012. The bank also sold the securities before maturity, which signals that they should be reported as impaired. Since Generic Bank did not report the losses as impaired, they could be in violation of ASC 326-30.

Part Two:

I feel that since Generic Bank claims that they have other means to sell capital, they sold the securities as part of an underlying strategic plan. In other words, they could have earned money for the employee bonuses and strategic acquisitions through other means other than selling the securities. It seems that they sold the securities voluntarily, which makes me believe there was no further foul play. I do not think that Generic Bank has any additional impairment losses other than the seven mentioned before.

Part Three:

As an external auditor, Heather should consider the following factors. First, she should determine how the fair value was measured as well as who was responsible for determining the values. She should also consider factors such as the consistency, timeliness, and reliability of the data that was used. My answer remains the same because I believe after considering these factors, Heather would draw a similar conclusion.

As a bank regulator, I feel that they would also come to the same conclusion. The securities were impaired, but since Generic Bank sold the securities voluntarily at year end, there is no reason to believe that additional securities would be impaired.

Again, both roles should consider how fair value was assessed as well as who did the assessment. Since fair value is a base for determining whether a security was impaired, it is important to understand where the values come from.

Part Four:

Out of the seven aforementioned securities, two of them (67 and 96) were in a gain position. I feel that if all of the securities were sold in a gain position, it might affect how the securities were reported. Since it is a cash inflow for the company, the procedures and values would probably be under more scrutiny to ensure that the calculations were accurate and consistent across the board. Through the eyes of an auditor, if all of the securities had been sold in a gain position, it would cause a red flag and would initiate a more thorough investigation of what is really going on with the company.

Part Five:

Though the bank is now adequately capitalized rather than well capitalized, my answer remains the same. Even though the bank is not in the absolute best position now, it is still in an effective position as far as finding other means to pay for employee bonuses and additional investments. My answer would change if the bank was in poor condition, but since it has only dropped slightly, I do not feel that it affects my answer.

CASE STUDY FIVE: City Selection Case

CASE STUDY FIVE: City Selection Case

Throughout this case, the student must consider two of their potential internship location options. You may think that this is crazy and that we should not be worrying about where we will live just yet. However, the question comes up every time a recruiter comes to our campus. They always want to know two things. Where do you want to live, and are you considering, audit or tax? It is important to go ahead and consider where we are interested in doing our internship because this location should also be a place we can see ourselves for about five years after college. It is important to stay loyal to the office that you do the internship for since they have committed their time and money towards you. I really needed to consider my location options more in depth, so this case gave me the opportunity to consider my options in a more practical sense.

This case helped me completely eliminate one of my location options. I grew up in the South, so I had always considered staying along the Southeast coast or Texas, since all of the big cities there are around the same driving distance from where I grew up. Unfortunately, I learned that South Mississippi is not the only place that is hotter than the devil's armpit. There is also Houston. I feel comfortable about my decision though with Houston because though it is one of the biggest cities in the nation, there are many similarities between Houston and where I grew up. I grew up on the water, so being close to the coast is important me.

Other things considered in this case where things like where I would be living, how I planned on commuting, and how I would be budgeting my money each month. I was shocked to find that the cost of living (for an apartment at least) was not much different than the cost to live in Oxford. Commuting and budgeting come easy because I have always had to drive anywhere I go, and I have been working and saving money since high school. It was also interesting to look in depth at what each of the cities offered. Things like entertainment, shopping, and concert venues were all fun things to research. Through this case, I have at least narrowed down one of my primary options. In the future, I would like to consider more location options using this case. I plan to visit some of my potential locations over break, so hopefully, I will have a final decision on where I want to live before next semester when the firms begin interviews.

Houston, Texas

- Population ~2.3 Million
- Houston is described to have a subtropical climate. Highs of around 90+ degrees in the summer months, lows of around 40 degrees in the colder months. Average rainfall is about 48 inches annually, which tends to cause flooding over portions of the city.
- Houston is located on the Gulf coastal plain. Much of the city was built on forested land such as marshes and swamps. Since the local terrain in Houston is so flat, flooding is a major recurring problem for the city as noted above.

- Salary projection with relevant taxes:

Salary		**$50,000**
Federal Income Tax	**(4,370)**	
Social Security	**(3,100)**	
Medicare Tax	**(725)**	
Total tax		**(8,195)**
Net pay		**$41,806**

- Texas does not require a state income tax, but the expense is normally made up through higher property taxes. The sales tax rate for Houston is 8.25 percent, with state, county and city sales tax considered. It was difficult to estimate property taxes, since I would be considering renting an apartment and not owning my own home for the first few years.
- Houston's freeway system is made up of 575.5 miles of freeways and expressways. Houston is also served by two commercial airports, George Bush Intercontinental Airport (IAH) and William P. Hobby Airport. Another form of transportation within the city is the METRO light rail.
- Houston has a broad industrial base in the energy, manufacturing, aeronautics, transportation, and health-care sectors. FUN FACT: Houston is home to the Johnson Space Center, where the NASA's Mission Control Center is located!

- Houston became the home of the Texas Medical Center, the world's largest concentration of healthcare and research institutions. More heart surgeries are performed at the Texas Medical Center than anywhere else in the world. Some of the academic and research health institutions in the center include Baylor College of Medicine, The University of Texas Health Science Center at Houston, The Methodist Hospital, Texas Children's Hospital, and The University of Texas M. D. Anderson Cancer Center. M.D Anderson is one of the top two cancer research centers in the nation. I would have to say the quality of the city's healthcare is top-notch.
- Houston has two of the most dangerous neighborhoods in the U.S., according to the Houston Chronicle. The areas to avoid are Houston's Third Ward neighborhood near the University of Houston and Sunnyside south of Downtown Houston. These areas have a very high crime rate, especially for violent crimes. Another neighborhood not listed in the Chronicle report is the Southwest side of Houston. There is gang related activity, especially at night.
- Briarwood Village is an apartment complex that shows a one-bedroom apartment for rent for about $800 a month. This rent is actually pretty comparable to the rent in Oxford, which I found shocking. Some of the amenities included are:
    - Swimming Pool and Spa
    - State-Of-The-Art Fitness Center
    - High-Speed Internet Access
    - Guest Parking
    - Easy Access to Freeways and Public Transportation

- Easy Access to Shopping
- Public Parks Nearby

More amenities related to the individual apartment are:

- Central A/C and Heating
- Cable-Ready
- Wood-Burning Fireplaces
- Walk-In Closets
- Balconies and Patios
- Washer and Dryer Connections
- Furnished Apartments Available
- Pet Friendly

Figure 5-2: Here is an example of a floor plan that I am interested in (Guadalupe) at Briarwood Village.

- Most people living in surrounding areas make the commute into the region via car. The good news is that downtown usually has plenty of parking. The average commute time is roughly 29.5 minutes.
- H-E-B, I have heard that there are tons of variety at low prices!
- I hope to find an apartment here a washer and dryer is included!
- Civic Foundations in Houston:
    - Galveston Bay Foundation- It's the foundation's mission to advocate, conserve, and educate. It is aimed at promoting water quality and bay health, preserving the vital resource, and increasing public access to it.
    - Children's Assessment Center- When a child is the victim of sexual abuse in Harris County, this group steps up, connecting families to psychological services and working with law enforcement, CPS, and other agencies to spare victims potentially re-traumatizing trips to the

hospital or police station, thanks to its on-site medical clinic and private, child-friendly spaces for forensic interviews.

    - Friends of Texas Wildlife- This organization cares for injured, displaced, and orphaned wildlife with the goal of rehabilitating and releasing them.

- Since I love to go to concerts and hear live music, The Continental Club and Warehouse Live are a couple of places I would like to go for fun. There is a variety of professional sports teams to watch, including the Houston Texans (NFL), the Houston Astros (MLB), the Houston Dynamos (MLS) and the Houston Rockets (NBA). There are also many shopping districts, which is a necessity, like Highland Village and River Oaks District.
- I plan to travel by car since it is roughly the same amount of time that it takes me to travel to and from school. I plan to spend about $150 in gas when travelling to Houston.

- Monthly Budgeted Expenses:

ITEM	AMOUNT
Rent/mortgage	**$800.00**
Electric	**$120.00**
Cell phone	**$45.00**
Groceries	**$300.00**
Auto expenses	**$100.00**
Auto Insurance	**$78.00**
Personal care	**$50.00**
Entertainment	**$100.00**
Miscellaneous	**$50.00**

- I would prefer Houston over Atlanta. I do not think I would like to live in Atlanta anymore after conducting my research. I do not feel that the city's culture would align with my own. Houston reminds me a lot of where I grew up, so I think Houston would be my primary option!

Atlanta, GA

- Population ~486,000
- Atlanta is also considered to be a subtropical climate. Highs of around 80 degrees in the warm months, lows of around 30 degrees in the cooler months. The winter month are slightly chillier than in Houston. Average rainfall is about 50 inches, and snowfall is projected at about 2 inches annually, though not very common.
- Atlanta has the highest average elevation of any major city east of Denver. The Eastern Continental Divide line also runs through Atlanta. The Chattahoochee River that crosses the metro area, and Stone Mountain, the world's largest chunk of exposed granite, are located just northeast of the city.
- Salary projection with relevant taxes:

Salary		**$50,000**
Federal Income Tax	**(4,370)**	
State Income Tax	**(2,510)**	
Social Security	**(3,100)**	
Medicare Tax	**(725)**	
Total tax		**(10,705)**
Net pay		**$39,296**

- The sales tax rate for Atlanta, GA is 8.9 percent, with state, county and city sales tax considered. It was difficult to estimate property taxes, since I would be considering renting an apartment and not owning my own home for the first few years.

- Hartsfield-Jackson Atlanta International Airport is a huge transportation hub. Atlanta also has a network of freeways. Many people living in Atlanta rely on their car as a primary source of transportation. Atlanta also has a subway system that is operated by Metropolitan Atlanta Rapid Transit Authority (MARTA).
- Several major national and international companies are headquartered in Atlanta such as Coca-Cola Company, Home Depot, and United Parcel Service. Also, over 75 percent of the Fortune 1000 companies have a presence in the Atlanta area. Delta Air Lines is also the city's largest employer.
- I could not find much information regarding the quality of Atlanta's healthcare specifically. Though, I did find that Georgia is one of the states with the worst health care nationally. This would raise a red flag for me.
- Statistics show Atlanta to be the eighth most homicide-prone city in the U.S., in part because of its position as a drug transit point. Atlanta gangs are also fairly active in certain neighborhoods. The most dangerous parts of Atlanta include U-Rescue Villa, Old Fourth Ward, Kirkwood (which is known for gangs), Castleberry Hill, Washington Park, Edgewood, Peoplestown, Vine City, and East Atlanta Village. On the outside of town, neighborhoods to avoid include Smyrna, Duluth, Dunwoody, Perimeter Center, and Norcross.

- I found a one-bedroom apartment at Panther Riverside Parc for about $900 a month. Though, this is more than the average, it is a really nice complex. Some of the amenities include:

    - Swimming Pool
    - Movie Theatre Seating
    - Fitness Center
    - Gated Electronic Entrance
    - Cat Friendly
    - Wi-Fi Available

More amenities specific to the individual apartment are:

- Upgraded Kitchens
- Garden Tubs
- Private Balcony
- Smoke Free
- Walk-In Closets
- Washer/Dryer Connections

Figure 5- 3: Here is a one-bedroom floor plan (Ritz) that averages around $900 a month at Panther Riverside Parc.

- Again, the primary mode of transportation is with a vehicle. The average commute time is about 31 minutes.
- Kroger, of course!
- I hope to find an apartment here a washer and dryer is included!
- Civic Organizations:
    - Atlanta Ronald McDonald House Charities- This organization's mission is to nurture the health and well-being of children and families.
    - Bert's Big Adventure- nonprofit organization that provides a magical, all-expenses-paid, five-day journey to Walt Disney World® for children with chronic and terminal illnesses and their families.

    - Hands on Atlanta- connects change makers to nonprofits and schools in need, while engaging socially responsible companies to help make a difference in the community.

- Since I love the outdoors, I would likely visit Piedmont Park in Midtown and Centennial Olympic Park Downtown. These locations also host many festivals and events. Though I am not a huge sports fan, I still would like to visit SunTrust Park to watch the Braves or to Mercedes-Benz Stadium to cheer on the Falcons. I went to Atlanta as a kid and I remember visiting the Coca Cola factory and the Aquarium, so those would also be places I would like to revisit.
- I plan to travel by car since it is roughly the same amount of time that it takes me to travel to and from school. I plan to spend about $150 in gas when travelling to home then back to Atlanta.

- Monthly Budgeted Expenses:

ITEM	AMOUNT
Rent/mortgage	$900.00
Electric	$120.00
Cell phone	$45.00
Groceries	$300.00
Auto expenses	$100.00
Auto Insurance	$78.00
Personal care	$50.00
Entertainment	$100.00
Miscellaneous	$50.00

- I would prefer Houston over Atlanta. I do not think I would like to live in Atlanta anymore after conducting my research. I do not feel that the city's culture would align with my own. Houston reminds me a lot of where I grew up, so I think Houston would be my primary option!

CASE STUDY SIX: WorldCom, Inc.—Capitalized Costs and Earnings Quality

CASE STUDY SIX: WorldCom, Inc.—Capitalized Costs and Earnings Quality

Throughout this case, the student must analyze the financial statements of WorldCom, Inc. and determine where and how they attempted to pull of one of the most world-renowned accounting frauds to date. First, we determined what was considered an asset and what was considered an expense. This helped in determining how to distinguish costs by either capitalizing them or expensing them, which is the big issue that WorldCom, Inc. failed to record correctly. The case then wanted us to restate earnings as they should have appeared in accordance with GAAP. After completion of this case, the student should have learned where WorldCom, Inc. went wrong in reporting their financials and how issues like this can be prevented with good accounting procedures.

Part One:

- **Assets** are future economic benefits that are obtained by a company as a result of a past transaction or event.
- **Expenses** are outflows or using up of assets or liabilities from delivering or producing goods, rendering services or the carrying out of the company's ongoing major or central operations.
- **Costs** should be expensed when they are used up or have no measurable future economic value. Costs should also be considered as an expense if they are just cost that simply maintain a given level of service. Costs should be capitalized when they do have future economic value and have not expired.

Part Two:

- After the initial capitalization, the cost of the expense should be depreciated until only the salvage value remains. Since the accumulated depreciation account will increase with the addition of depreciation expense, the balance sheet will show a decrease in the PPE account. Depreciation is recorded as an expense on the income statement, which will reduce net income.

Part Three:

- The line costs for the year ended December 31, 2001 were $14.739 billion.
- Journal Entry (in millions)

Journal Entry			
Date	**Account**	**Debit**	**Credit**
12/31/01	Line Costs Expense	14,739M	
	Cash		14,739M

- Line costs are costs that were incurred by WorldCom, Inc. during regular operations. These costs should have been recognized as expenses. Instead, these costs were capitalized fraudulently by WorldCom, Inc.

Part Four:

- The costs that were improperly capitalized were the charges paid to local telephone networks to complete calls. Instead of recognizing these costs as expenses, they were capitalized, which ended up overstating net income for WorldCom, Inc. These costs do not meet the definition of assets and should have been expensed.

Part Five:

Journal Entry			
Date	**Account**	**Debit**	**Credit**
2001	PPE	3,055M	
	Line Cost		3,055M

Part Six:

$771,000,000/22 years x 4/4 = $35,045,455

$610,000,000/22 years x 3/4 = $20,795,455

$743,000,000/22 years x 2/4 = $16,886,364

$931,000,000/22 years x 1/4 = $10,579,545

Total Depreciation Expense $83,306,818

Journal Entry			
Date	**Account**	**Debit**	**Credit**
12/31/01	Depreciation Expense	83,306,818	
	Accumulated Depreciation		83,306,818

Part Seven:

Income before taxes	$2,393,000,000
Add: Depreciation	$83,306,819
Deduct: Line costs improperly capitalized	$3,055,000,000
Loss before taxes	$(578,693,181)
Income tax benefit	$202,542,613
Minority Interest	$35,000,000
Net loss (2001)	**$(341,150,568)**

CASE STUDY SEVEN: Starbucks Corporation

CASE STUDY SEVEN: Starbucks Corporation

In this case, the student must look at a company overview, financial statements, and audit opinions and determine the financial status of the company under review. The case first instructs the student to recall some basic accounting terms and try to piece together where they fit in this case. At the same time, the student is interpreting financial reports made by both Starbucks Corp. as well as the external auditor. From these statements, the student is asked to explain how they perceive the opinion letters from the auditors. The next step is to use the financial statements given in the case to compile a common size income statement and balance sheet to help in comparing the information over a couple of years to see how the company is doing. The last step is to them compare and explain the data that is presented in the common size statements. After this case, the student will have successfully reviewed and interpreted a company's financial statements as well as compile that data into alternative statements for easy comparison. These skills will be very beneficial when beginning an auditing internship.

Starbucks is in the business of crafting and selling unique coffee and tea blends along with a variety of other drinks and pastries. They primarily generate money through the sale of these products at their store locations, but they have also expanded their operations to include their products in grocery stores and other markets to give their consumers the same quality products at the comfort of their own home.

The four primary financial statements used for external reporting are:

- Income Statement
- Balance Sheet
- Statement of Cash Flows
- Statement of Stockholders' Equity

Starbucks refers to the statements listed above as follows:

- Consolidated Statements of Earnings
- Consolidated Balance Sheets
- Consolidated Statements of Cash Flows
- Consolidated Statements of Equity

Financial statements are usually prepared four times a year in what is referred to as quarters. All of the accounting information used in these reports typically are representative of January 1st through December 31st of each year.

Managers of a company are responsible for financial statements. The implementation of the Public Company Accounting Oversight Board (PCAOB) created a checks and balances method that required managers, especially the CEO and CFO, to confirm that the statements are accurate. The most important user of the financial statements are the owners and stockholders of the company. Stockholders are a priority for publicly traded companies. Investors, or external parties, typically are interested in risk analysis and the return on their investment, while management, or internal parties, are more interested in managing an assessing the company's financial performance.

Deloitte & Touche LLP, Seattle, Washington are the external auditors for Starbucks. The first opinion letter describes the process in how the audit is performed as well as the auditor's findings and opinion on the presentation of the financial statements in accordance with generally accepted accounting principles. The second letter describes the importance of internal controls and assesses how the audit team ensured the controls were in place. The letter then gave Deloitte's opinion on the effectiveness of the internal controls. The opinions are dated at a later time period because it normally takes a couple of months to make sure all of the data is gathered, and the auditors have the sources they need to complete the audit.

Figure 7-1 Common Sized Consolidated Income Statement

Starbucks Corporation Common-Size Consolidated Statements of Earnings				
*In Millions, except Per Share data, unless otherwise specified				
	12 months Ended		12 months Ended	
	Sep 29, 2013		Sep 30, 2012	
Net Revenues:				
Company-operated stores	$11,793.20	79.2%	$10,534.50	79.2%
Licensed stores	1,360.50	9.1%	1,210.30	9.1%
CPG, foodservice and Other	1,738.50	11.7%	1,554.70	11.7%
Net revenues	14,892.20	100.0%	13,299.50	100.0%
Cost of sales including occupancy costs	6,382.30	42.9%	5,813.30	43.7%
Store operating expenses	4,286.10	28.8%	3,918.10	29.5%
Other operating expenses	457.20	3.1%	429.90	3.2%
Depreciation and amortization expenses	621.40	4.2%	550.30	4.1%
General and administrative expenses	937.90	6.3%	801.20	6.0%
Litigation (charge) credit	2,784.10	18.7%	-	0.0%
Total operating expenses	15,469.00	103.9%	11,512.80	86.6%
Income from equity investees	251.40	1.7%	30.00	0.2%
Operating income (loss)	(325.40)	-2.2%	1,997.40	15.0%
Interest income and other, net	123.60	0.8%	94.40	0.7%
Interest expense	(28.10)	-0.2%	(32.70)	-0.2%
Earnings (loss) before income taxes	(229.90)	-1.5%	2,059.10	15.5%
Income tax (expense) benefit	(238.70)	1.6%	674.40	5.1%
Net earnings including noncontrolling interests	8.80	0.1%	1,384.70	10.4%
Net (earnings) loss attributable to noncontrolling interests	0.50	0.0%	0.90	0.0%
Net earnings attributable to Starbucks	$8.30	0.1%	$1,383.80	10.4%
Earnings per share - basic	0.01	0.0%	1.83	0.0%
Earnings per share - diluted	0.01	0.0%	1.79	0.0%
Weighted average shares outstanding				
Basic	749.30	5.0%	754.40	5.7%
Diluted	762.30	5.1%	773.00	5.8%
Cash Dividends declared per share	$0.89	0.0%	$0.72	0.0%

Figure 7-2: Common Sized Consolidated Balance Sheet

Starbucks Corporation Common-Size Consolidated Balance Sheet				
*In Millions, unless otherwise specified				
	Sep 29, 2013		Sep 30, 2012	
Current assets				
Cash and cash equivalents	$2,575.70	22.4%	$1,188.60	14.5%
Short-term investments	658.10	5.7%	848.40	10.3%
Accounts receivable, net	561.40	4.9%	485.90	5.9%
Inventories	1,111.20	9.6%	1,241.50	15.1%
Prepaid expenses and other current assets	287.70	2.5%	196.50	2.4%
Deferred income taxes, net	277.30	2.4%	238.70	2.9%
Total current assets	5,471.40	47.5%	4,199.60	51.1%
Long-term investments	58.30	0.5%	116.00	1.4%
Equity and cost investments	496.50	4.3%	459.90	5.6%
Property, plant, and equipment, net	3,200.50	27.8%	2,658.90	32.3%
Deferred income taxes, net	967.00	8.4%	97.30	1.2%
Other assets	185.30	1.6%	144.70	1.8%
Other intangible assets	274.80	2.4%	143.70	1.7%
Goodwill	862.90	7.5%	399.10	4.9%
Total Assets	11,516.70	100.0%	8,219.20	100.0%
Current liabilities				
Accounts payable	491.70	4.3%	398.10	4.8%
Accrued litigation charge	2,784.10	24.2%	-	0.0%
Accrued liabilities	1,269.30	11.0%	1,133.80	13.8%
Insurance reserves	178.50	1.5%	167.70	2.0%
Deferred revenue	653.70	5.7%	510.20	6.2%
Total current liabilities	5,377.30	46.7%	2,209.80	26.9%
Long-term debt	1,299.40	11.3%	549.60	6.7%
Other long-term liabilities	357.70	3.1%	345.30	4.2%
Total liabilities	7,034.40	61.1%	3,104.70	37.8%
Stockholders' equity				
Common stock	0.80	0.0%	0.70	0.0%
Additional paid-in capital	282.10	2.4%	39.40	0.5%
Retained earnings	4,130.30	35.9%	5,046.20	61.4%
Accumulated other comprehensive	67.00	0.6%	22.70	0.3%
Total stockholders' equity	4,480.20	38.9%	5,109.00	62.2%
Non-controlling interests	2.10	0.0%	5.50	0.1%
Total equity	4,482.30	38.9%	5,114.50	62.2%
Total liabilities and equity	$11,516.70	100.0%	$8,219.20	100.0%

Total assets for the year ended 2013 were $11,516.70 which is equivalent to the total liabilities and stockholders' equity, $11,516.70.

- The major assets on the balance sheet are cash and cash equivalents, property, plant and equipment, and inventories.
- Short term assets: $5,471.40 / 11,516.70= 47.51%
- Long term assets: $6,045.30 / 11,516.70= 52.49%

Intangible assets are assets that are not physical in nature. They can include things like patents, trademarks, brand recognition, and goodwill. Goodwill is the intangible asset that is related to the value of a brand or company. Starbucks has biggest intangible asset would be brand recognition because of their unique logo that can be identified across the world.

Since there is a greater proportion of debt that is financed through non-owners, we can imply that Starbucks finances mostly through non-owners. While there is some financing through owners, it is not as significant as the amount by non-owners. The proportion of total financing that comes from non-owners is as follows:

% of Financing from Non-Owners = Total Liabilities / Total Assets

= $7,034.40 / 11,516.70 = 61.08%

It seems that Starbucks uses both methods depending on the type of store that is in question. For the company-operated stores, revenges are recognized at the point of sale. For the licensed store though, revenues are only recognized when a shipment is processed. Store value cards revenue is recognized when the amount has been redeemed. It seems that there could possibly be inconsistency when comparing these revenues since different methods call for different accounting. The depreciation/amortization expense and litigation charge made up the bulk of the difference.

According to the statements, it seems that Starbucks major expenses are cost of sales that include both the occupancy cost as well as the store operating cost. In the most recent year, it seems that revenues increased at a pretty high rate, but since there was also a large amount of expenses and an additional litigation charge, net income remained similar in 2013 as it was in prior years. Since the litigation charge is an unusual item, it must be disclosed in the financial statements and must be presented separately. The charge is not part of operation expenses because it is infrequent in occurrence and is only affecting 2013 financials. After analyzing the company's profit margin, return on assets and return on equity, it is clear that Starbucks is still making a significant amount of profit, despite the decline in profits in 2013.

Net cash is calculated by adding net income to adjustments to noncash expenses and changes in working capital. I arrived at net cash provided by operating expenses of \$2,908.3 million. Net earnings are simply revenues minus expenses, which gave me \$8.8 million. As we can see, net cash is significantly larger than net earnings.

- Property, plant, and equipment equaled $1,151.20 in 2013.
- As of 2013, the cash dividend paid was $629 million and an additional $196 million was paid in after year end. If a company declares a dividend, it does not always mean that the dividend has been paid, which may lead to inconsistencies in the financial statements.

CASE STUDY EIGHT: *Deepwater Horizon*

CASE STUDY EIGHT: *Deepwater Horizon*

In this case, the student was instructed to understand the meaning of a contingent liability and how these liabilities played a role in the BP oil spill. In 2010, there was an explosion of one of BP's rigs in the Gulf of Mexico that released over two hundred million gallons of oil into the gulf. Over one hundred and fifty thousand claims were filed against the company in relation to the damages incurred by the oil spill. As you can imagine, these claims accumulated to over twenty billion dollars in damages. BP was then tasked to estimate the amount of loss from this disaster to present to shareholders and to report on their financial statements. Since the likelihood of additional damage occurring was high, BP not only had to assess the primary damages, but also the liabilities that they could potentially be held accountable for in the upcoming months. These included environmental, industrial, and economic claims. The student is to research possible contingent liabilities related to the oil spill and determine how these losses should be reported and when they should be reported on the financial statements.

This case was very interesting for me because I live on the Mississippi Gulf Coast and saw first-hand how this impacted residents along the coast. Looking back now, the impact that the spill had on the coastal residents were secondary to the initial claims that the BP was receiving. I have actually seen the movie, *Deepwater Horizon*, that portrays the story and the people involved in the incident. The company was negligent and being negligent has its consequences. Many people died because of the official's negligence and many people were injured or now face medical complications as a result from the oil spill. Many animals and ecosystems died out or even lost their habitats due to the oil spill, and these were all things that happened secondary to the initial explosion. Oil is a very dangerous business. Many lives can be impacted by the mistake of just a few people. It was very interesting to research and understand the claims made against BP and how this incident affected so many peoples' livelihood.

A contingent liability is loss that deals with a certain amount of uncertainty. It is important to understand the probability that the loss will actually occur. A company records a contingent liability if they believe that the loss is highly likely to occur. The contingent liability is then reported as a liability on the balance sheet and as a loss or expense on the income statement if the loss is probable and the amount can be reasonably estimated. Most contingent liabilities stem from lawsuits, warranties, or investigations involving the company like in the BP case. Contingent gains are not recorded because it goes against the principle of conservatism in accounting.

Even though GE Oil and Gas manufactured a telescopic joint that may have proved to be defective, the installation of the product was the main issue in the *Deepwater Horizon* incident. If the product was defective, BP could have returned or exchanged the product within the two years. In the case of *Deepwater Horizon*, BP officials were given warnings that they ignored about the conditions of the vessel. Therefore, the fault falls on BP. If they would have taken precautions and adhered to the warnings, the defective product could have been returned or exchanged. Since the problem occurred due to the installation of the product, GE Oil and Gas was not at fault.

Management needs to determine the probability of the loss occurring. In the BP case, there were many environmental, economic, and health factors that needed to be estimated to determine the amount of loss. Since the risk of loss for the *Deepwater Horizon* incident is extremely high, there would be a liability recorded. The difference in a claim for damages and a claim for a defective product differs in that a product can simply be returned or exchanged. As for damage claims regarding the oil spill, it is difficult to determine the amount of loss regarding the spill because so many different areas were affected. BP must take into consideration the environmental impacts, loss of life due to the incident, as well as industries along the gulf coast that were affected economically.

The final amount determined for the damages were $20.8 Billion. Many different industries were affected second handedly by the oil spill. Many businesses along the coast lost revenue and business because of the oil spill. Some of the specific estimates that were used to determine the amount of damages incurred are listed below.

<u>Natural Resources</u>

- Clean Water Act
- Oil Pollution Act
- Migratory Bird Treaty Act
- National Fish and Wildlife Foundation (NFWF)
- National Academy of Sciences (NAS)
- EPA

Economic Losses

Tourism and restaurant industries were affected economically along the coast, with the oil spill affecting the coastline, many restaurants and tourism industries lost business after the wake of the oil spill.

Health Related Claims

- 14 criminal charges
- 11 counts of felony manslaughter

As you can see, many organizations and businesses were affected well beyond the initial impact of the spill. As an auditor, it would be important to determine the economic impact on the businesses along the coast. I grew up on the gulf coast, so I remember the impact the oil spill had on the businesses. The beaches and casinos were essentially desolated because not many people visited the coast that Summer because of the oil spill. Though it seems to be a secondhand impact, these businesses were affected, and some family owned/local restaurants even closed that Summer due to the loss of tourism. This is just one aspect of the damages incurred by the oil spill. An auditor would have a very difficult time helping the company determine the estimate to record for the liabilities because of how enormous the effect was.

Case Study Nine: Wendy's Corporation-Equity Method Investments

Case Study Nine: Wendy's Corporation-Equity Method Investments

In this case, the student is required to understand and learn how to account for equity method investments. Wendy's Corporation has entered into a joint venture with another company, Tim Hortons. This case allows the student to determine how to account for gains and losses, as well as, how to report excess amounts over the purchase price of the acquisition. Since Wendy's has not taken complete control over Tim Hortons, they should not consolidate their financial statements, but they should still report amounts of gains and losses in regard to the investment. The student essentially goes through these various journal entries and determines which accounts are affected, as well as, where these accounts show up on the financial statements.

It was very interesting to learn about the equity method for investments. I found myself struggling at times, since I am in Intermediate I and have not covered this topic in class yet, but overall, the equity method was interesting to learn about. Luckily, Dr. Dickinson gave us a run down and brief overview of the equity method of investments during class, so that helped me get on board and see how to work through the problems. Since Wendy's is a corporation most of us are very familiar with, it was very fascinating to look into their financials and see how they account for certain events. I liked this case because it gave me a better idea of what I will be doing as an auditor. The case involved a realistic company with a realistic event, which made it all the more fun.

- The reasons behind forming a joint venture include business expansion, development of new products or moving into new markets. Joint ventures also allow companies to share the risk associated with doing business.
- The Equity method of accounting is used for investments. It is normally used when the investor holds a significant amount of influence over the investee, but does not exercise full control over the company, similar to a parent company and a subsidiary. Wendy’s will recognize its share of earnings and losses in conjunction with Tim Hortons. These amounts of earnings or losses will be reflected on Wendy’s income statement and balance sheet, and they will be calculated according to the ownership percentage that Wendy’s has in the common stock of Tim Hortons (in this case, fifty percent). As for dividends, Wendy’s will subtract out the number of dividends issued by Tim Hortons from the carrying value of the original investment.
- Wendy’s should account for the excess amount as goodwill under the equity method of accounting. They can also take the excess amount over the purchase price and allocate (write-up) the amount to other companies they have invested in. This is known as an acquisition accounting premium (AAP).
- In 2011, Wendy’s reported $119,271 as “Equity Investment” on their consolidated balance sheet. The amount decreased to $113,282 in 2012.
- Wendy’s investment in TimWen at December 31,2012 is $89,370. Wendy’s share of TimWen equity on December 31,2012 is $35,282. Therefore, making the difference equal $54,088, which is the amount of AAP to write up.

- In 2012, earnings before taxes were $10,551 ($13,680-$3,129).
- In 2011, earnings before taxes were $10,571 ($13,305-$2,934).
- Wendy reports this in the consolidated statements of operations under "Other operating expenses."

Wendy's share of TimWen's 2012 earnings is recorded as:

Equity Investment	13,680M	
Equity Income		13,680M

Amortization of the purchase price adjustments for 2012:

Equity Income	3,129M	
Equity Investment		3,129M

Receipt of dividends from TimWen for 2012:

Cash	15,274M	
Equity Investment		15,274M

- When the earnings were discovered, they were included in net income. Now in case of a non-cash transaction, the amounts should be subtracted from the net income value.
- This presents earnings before taxes of $8,724 ($10,551-$1,827).
- "Dividends from cash" was not included in the statements. The amount ($15,274) should be the same as the account of "Distributions Received" in (Note 8).

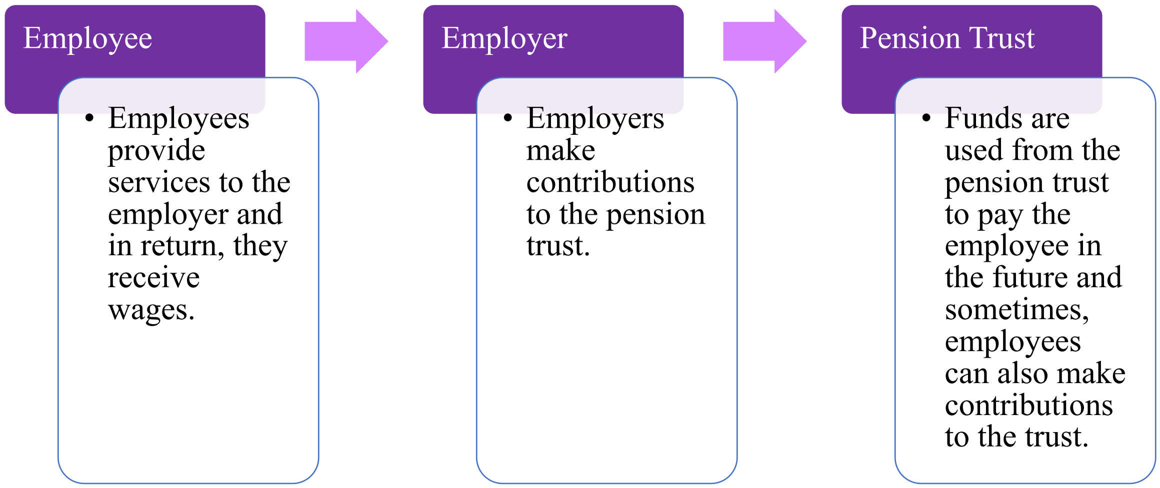
CASE STUDY TEN: Johnson & Johnson's Retirement Obligations

CASE STUDY TEN: Johnson & Johnson's Retirement Obligations

In this case, the student is required to understand and report the retirement obligations on the books of Johnson & Johnson during the years 2006 and 2007. The student must also explain the different types of retirement plans, they are also required to develop a visual to show how pension cash flows from employees, to the employer, then to the pension trust. Pensions are a significant topic in the business world. Many companies use retirement benefits, as well as healthcare and insurance benefits, as incentives for employees. It is important for students to understand how pension obligations should be accounted for.

- The difference between a defined contribution plan and a defined benefit plan is that in a defined contribution plan, the employer agrees to contribute an allotted amount to a pension fund for the employee that is based on a predetermined formula. In a defined benefit plan, the employee's benefits are based off of their years of employment, as well as, their compensation level. Johnson & Johnson offers a variety of retirement and pension plans, including defined benefit, defined contribution, and termination indemnity plans.
- Retirement plan obligations are considered a liability because they are an obligation for the employee to pay a defined amount sometime in the future. Retirement plan obligations are similar just like compensation for employees, so they should be recorded as a liability on the financial statements. On the next page is a diagram that shows how the pension cash flows between an employer, the employee, and the pension trust.

Figure 10-1: Pension Plan Process



- An actuary’s job is to make an assumption about how long an employee will live based on a predetermined formula. They are also tasked with determining when they believe the employee will retire, and how long they expect the employee to live after retirement.
- Service cost is the expense that is charged when an employee provides services or work to the employer, which consequently obligates the employer to provide retirement benefits in return. Since a pension obligation is a form of deferred compensation, interest costs are considered. Actuarial gains or losses are based off of the predictions made by the actuaries and how far they were from what actually happened. Benefits are normally in the form of compensation, but can

include things such as healthcare, that works as an incentive for an employee to stay with a company and have the ability to retire with a "savings" built up.

- The actual returns on the pension investment are the dividends and interest received on plan assets. At the beginning of the year, the company must determine how much return it expects to receive on its plan assets. At year end, it must report the returns it recognizes. The company contributions are the amounts invested in the pension plan assets during a period of time, while the benefits paid are the distributions paid to former or retired employees.
- One of the returns measures the return on the pension fund investments, while the other form of return measures the difference between this predicted return and the actual return recognized on the investment. The two methods are different so pension fund investments can be tested to see if they are performing as well as predicted. Increases and decreases in the pension's rate of return can also be determined under this method. Retirement benefits are classified as liabilities and some of them are strictly defined. They can also be based on the employee's compensation level and years of service, while other benefits, such as healthcare or insurance, are not tied to these items. Healthcare and insurance are also not funded beforehand, which differentiates them from retirement obligations.
- Johnson reported $646 million on its 2007 income statement.

Annual Pension Expense	1,253M		
		Projected Benefit Obligation-Service Cost	597M
		Projected Benefit Obligation-Interest Cost	656M

- The value of the plan obligation at 2007-year end is $337 million. This value represents the predicted amount that Johnson & Johnson will be responsible for paying its employees when they retire. Since there are so many factors that affect this assumption, it is not that reliable, but it is the best estimate that can be determined given the current information.
- The interest cost for 2007 is $656 million. Johnson & Johnson reached this amount by using an average interest rate of 5.6 percent. Johnson & Johnson would need to compare this interest rate to similar investments in the market that have similar assumptions and time periods. During the year, $46 million was paid into retirement benefits. These benefits are not paid in cash. Paying existing obligations decreases both the plan assets and the plan obligation because the assets are used to pay the retirement obligations. The assets no longer belong to Johnson & Johnson. The value at year end of the retirement plan assets is $10,649 million. This is the fair value of the investment and the contribution that Johnson & Johnson has to pay off the obligation of its retirement plan.
- In 2006, the expected return on the plan assets were $701 million, and the expected return for 2007 was $809 million. The actual return in 2006 was $966 million, and the actual return fin 2007 was $743 million. The variances in 2007 was only an 8 percent change, therefore it would not be considered significant. The variance in 2006 was a 27 percent change, so it was considered a significant change. The actual return better reflects the company’s pension expense because it is an actual amount.
- In 2007, Johnson & Johnson contributed $317 million to tis retirement plan and

its employees contributed $62 million. These amounts are larger than the contributions in 2006, which were $259 million from the company and $47 million from its employees.

- 67 percent of equity securities, 32 percent of debt securities, and one percent in real estate and other investments make up Johnson & Johnson's retirement plan assets.
- In 2006, Johnson & Johnson's retirement plan was underfunded by $2,122 million, and in 2007, the plan was underfunded by $1,533 million. This information can be found in the "Fund status at the end of the year" line, which is located in the change in plan assets section. This amount can also be seen in the projected future contributions table.

CASE STUDY ELEVEN: Balance Sheet Method

CASE STUDY ELEVEN: Balance Sheet Method

After reading an article that sparks a debate on why the authors believe that the income statement method should be used in place of the balance sheet method, the student is required to summarize the authors views on why they believe the income statement is preferred, as well as, why they believe this method more beneficial over the original method. The article goes into great detail about the advantages of the income statement method and how it can provide more concise reporting. The authors also explain why the balance sheet method of reporting is not as popular anymore because of its inability to value assets at accurate amounts. The balance sheet method also fails to distinguish operating from financing activities, which can cause potential problems in reporting. The student is then asked to evaluate what the article taught them and how they believe this information would affect their future in accounting. Overall, this case was very interesting because it showed students a real life issue the FASB is facing today and how professionals are sparking debates in order to get the FASB to reconsider their framework.

In the article, “On the Balance Sheet-Based Model of Financial reporting,” the authors spark a debate regarding the faults of the balance sheet approach and why they believe the income statement approach is a more consistent method for financial reporting. While the balance sheet method focuses primarily on the proper valuation of assets and liabilities, the income statement approach views the determination of revenues, expenses, and earnings as the primary goal of financial reporting. Since investors, focus mainly on a company’s ability to generate earnings, and they are interested in the projection for future earnings, the income statement method more closely aligns with this goal in financial reporting. As the FASB continues to work toward convergence with the IASB, they are faced with the issues regarding the balance sheet method of accounting. Will modifications to the current method be enough to offset valuation issues, or is it time to switch to the alternative method, the income statement approach?

Another problem with the balance sheet method is that it does not distinguish operating and financial activities, which can lead to distorted reporting and eventually lead to misconstrued earnings. The authors believe it is important for the FASB to truly consider what is at hand. Instead of just modifying the way things have always been done, maybe it is time to take a deeper look into alternative means of financial reporting to create a more consistent method of reporting that reduces subjectivity in valuation and provides a more precise measure in regard to a company’s earnings.

I believe it is very interesting to see the FASB and IASB are currently working towards convergence. Talk of the convergence have been introduced in our textbooks, so it is very interesting to see the two bodies actually at work. I agree with the authors in the sense that it is time for the FASB and IASB to determine how they want to move forward. A very interesting quote from the article was, “the balance sheet approach would make sense if the firms were ‘asset greenhouses’, but most firms are more like ‘asset furnaces.’” It is important to understand that the balance sheet method puts so much emphasis on assets, where the goal is to earn money by acquiring assets, growing them, then letting the earnings follow accordingly by the unrealized or realized growth.

Whereas, in the income statement method approach, the assets are sacrificed in order to produce revenue and earnings, which should be the primary goal for a company. I believe it is time for the FASB to take into more serious consideration the income statement approach. This article does a thorough job of explaining how this approach provides better insights for not only the company in budgeting, but also for investors interested in the condition of the company.

I never realized the impact that asset valuation could have on financial reporting. After all, most of these valuations come from estimates or market-based measures, so it is important to understand that these estimates can sometimes prove to be subjective. The authors bring up the case of Enron and how their subjectivity lead to earnings managing. This is a potential risk for the profession if we continue to us the balance sheet approach. The balance sheet approach also does not do a good job of distinguishing operating and financing activities. Although financing activities are important, the income statement method provides a better reflection of operations by divorcing operating activities and financing activities. The income statement approach also focuses on matching. Matching provides a process of coordinating expenses with the revenues they are generating. Overall, it is important for the FASB to expand their efforts in re-assessing the existing conceptual framework.

If FASB decides to adopt the income statement approach in lieu of the balance sheet approach, the profession can expect to experience these repercussions of this process for many years to come. At the same time, the FASB should begin looking at the options because the costs of having a deficient reporting model can be substantial. It is better to go ahead and fix what needs to be fixed rather than continue to use a defective system. Using the right model of reporting can contribute in great lengths to the future of the profession.

With these changes, I believe that the valuation methods of assets will be completely revolutionized. Since there is so much debate regarding the accuracy of these valuations, the FASB will need to come up with an effective way of reporting these assets in a way that is consistent and comparable among all companies. The financial statements will also be impacted by this switch. For example, the balance sheet will need to separate assets from operating and financing activities because of their different implications for valuation. The FASB has already reported a change in the way income will be reported. It now includes separate income totals for a company's operating, investing, and financing, and tax activities. Another financial statement affected is the statement of cash flows. It will also include a separation of operating and financing activities. This is important since the balance sheet method does not do an efficient job of doing so already.

These new changes will impact the future of accounting for years to come, but it is important to go ahead and correct these issues and begin implementing income statement approach in order to create a better future for the profession. The faster the FASB begins to implement the new method, the better off the accounting world will be. We have always learned throughout our time in college that assets are the most important items a company has possession of but referring to the "asset greenhouse" reference from earlier, a company is much more than its assets. A company's ability to generate revenue and match those revenues with expenses allows for more faithfully representational reporting. It also allows for a company to segregate investing, financing, and operating activities, which is important when determining what the users of these financial statements are looking for.

If the FASB decides to adopt the income statement method, many changes can be expected in determining an assets value and reporting amounts on the financial statements in their respective sections. Since this has been an ongoing debate for the past years, I believe there may not be an immediate response form the FASB, but it is still important for authors, such as these, to help spark debate and allow the FASB to hear the opinions of professionals in the field regarding what they believe to be the most beneficial method for reporting purposes. I look forward to learning about the process the FASB uses to form their arguments for and against the income statement method and why or if they believe the current method should continue to be employed with modifications or if they believe adopting the alternative approach would prove to be more beneficial.

CASE STUDY TWELVE: Google and Non-GAAP Measures

CASE STUDY TWELVE: Google and Non-GAAP Measures

Throughout his case, the student is required to read a press release along with accompanying charts and tables that relate to Google's GAAP financial reporting along with their non-GAAP financial reporting and then analyze how these items affected items such as market growth and stock price. After reviewing the press release and accompanying notes and charts, the student is required to analyze the stock price per share growth following the press release and analyze the comparison of Google's return on stock to other companies reported in NASDAQ. At the end of the case is an article that reports the actual results regarding market growth and stock price for the year following the press release. As shown in the charts, Google received positive feedback from the market regardless of the negative implications that non-GAAP measurements may have. This case was very interesting because it allowed the student to see firsthand how important it is for companies to be transparent with their investors in order to maintain positive market growth.

- The difference between Google's GAAP net income and the non-GAAP equivalent is a total of $720 million. This amount includes the effects stemming from the elimination of stock-based compensation plus its tax effects, the elimination of restructuring and related charges along with their tax effects, as well as, the elimination of net loss from discontinued operations.

I believe it is acceptable for Google to report these amounts separately from their GAAP financial reporting because these are items that are not in the normal course of business for Google, which means that they are not likely to recur in the future. When reporting financial information to investors, these items may cause a negative response from shareholders because they would decrease net income. It is acceptable for a company to report these items as non-GAAP measures at the end of a period as long as they also report the reconciliation of GAAP and non-GAAP measures as a means to show the investors where the variance is coming from. It serves as an opportunity for the company to report in a faithfully representational way, while also explaining to the shareholders the reasons for these negative nonrecurring effects. Since Google provided a chart of reconciliation, I agree that their non-GAAP measures are justified.

Google reported a vast amount of growth between 2012 and 2013. The CEO reported that Google achieved great progress across a wide range of product improvements and business goals. These factors, plus the many other factors included in the press release, could be the cause of Google's growth in the stock market from 2013 to 2014. As long as Google maintains an open communication with their shareholders as they did in the 2013 press release along with their additional reconciliation table, shareholders will continue to invest.

All companies have unexpected expenses or unrelated items that affect their income, but ways they can help alleviate these negative items is by staying transparent and keeping the shareholder sin the loop. As we can see in the stock market chart for the years 2013 to 2014, Google's ability to communicate with their shareholders allowed them to continue to see positive growth regardless of the additional non-GAAP measures reported.

As we can see in the chart, Google maintains a higher cumulative stock return in comparison with other companies that are reported within the NASDAQ. This could be because of the abovementioned reasons. Other companies may have less transparency with their stockholders which can potentially lead to problems with investors. Google does a pretty good job of keeping communication open between the company and its investors, and that is one of the main reasons we see their increased growth in the market regardless of what is reported in the press release. The press release seems to have had a positive impact on the market. The shareholders perceived this information as good news. We see a growth in the stock price from the year 2013 to 2014. It is reasonable to believe that the price per stock will continue to stay in a growing state. Although the nonrecurring items sum up to be $720 million, Google allows shareholders to see the impact that amount will have on operating income and allow them to understand the reasoning behind the non-GAAP measures being taken into account.

Analysts predicted Google's to grow to $12.20 per share. Although Google saw a significant increase in net income and price per share, the shares only amounted to be $12.01 per share, which is still a significant increase. The relations are consistent with the positive stock market reaction following the press release. Google reported shares leaping 4 percent in after-hours trading following the press release. Google shares have also risen about 60 percent since the beginning of 2013. It is consistent to report that the press release allowed a significant amount of market growth regardless of the non-GAAP measures reported. New image-based ads seem to have been particularly successful. This seems to have been a marketing area where Google was struggling with competitors before, but it seems that the implementation of their new ads has been a great success.

The ads now allow consumers to find and buy items more efficiently on their phones. With a huge spike in online retail shopping, these ads will prove to be very successful for Google. I do not see any factors that might cause investors to be concerned with Google's recent performance based on the article.

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this ACCOUNTING RESEARCH AND PROFESSIONAL DEVELOPMENT THESIS.

Signature:

Ragan Riley

Works Cited

Dichev, Ilia D., *On the Balance-Sheet Based Model of Financial Reporting* (August 2007) p.1-43.

Financial Accounting Standards Board (FASB). 2016. *Financial instruments – Credit losses (Topic 326).* FASB Accounting Standards Update No. 2016-13. Norwalk, CT: FASB.

West, Jen. *"Winner: Best Local Charity in Atlanta | Best of Atlanta."* Ajc, For the AJC, 4 Oct. 2018, www.ajc.com/lifestyles/winner-best-local-charity-atlanta-best-atlanta/eFI0ywBh2oM9Aohkmn1YtN/.

"When Should Costs Be Expensed and When Should Costs Be Capitalized? | AccountingCoach." AccountingCoach.com, www.accountingcoach.com/blog/when-should-costs-be-expensed-and-when-should-costs-be-capitalized.

"22 Nonprofits Worthy of Your Time, Money, or Both." Houstonian, 20 July 2018, www.houstoniamag.com/articles/2018/7/20/nonprofits-houston.