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A Comprehensive Analysis of Accounting Topics Through Case Studies

Grant M. Rudow
University of Mississippi

A COMPREHENSIVE ANALYSIS OF ACCOUNTING TOPICS THROUGH CASE STUDIES

by

Grant Michael Rudow

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

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Approved by

Victoria Dickinson

Advisor: Dr. Victoria Dickinson

W. Mark Wilder

Reader: Dean W. Mark Wilder

ABSTRACT

GRANT RUDOW: A Comprehensive Analysis of Accounting Topics through Case Studies

(Under the direction of Victoria Dickinson)

The following thesis is a combination of twelve accounting case studies that were presented as curriculum in the Accounting 420 class. Each case contains a different topic and demonstrates a deep analysis in accounting theory and the current industry, in accordance with the Generally Accepted Accounting Principles set by the Financial Accounting Standards Board. This thesis demonstrates an in-depth knowledge of core accounting principles and standards, and their relation to academia and industry practice. The case studies were completed under the direction of Dr. Victoria Dickinson in fulfillment of the requirements for The University of Mississippi, Sally McDonnell Barksdale Honors College, and the Patterson School of Accountancy ACCY 420 course in the 2018-2019 academic year.

ACKNOWLEDGMENTS

First, thank you to my parents who have always been by my side and have pushed me to excel in everything I do. Thank you to all my friends and family who have supported me throughout my academic career. To the Sally McDonnell Barksdale Honors College, thank you for providing such an enriching learning experience and community. And lastly, thank you to the Patterson School of Accountancy and all my professors for guiding me throughout my journey at The University of Mississippi.

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CASE 1: Google Fusion

An Analysis of Data Analytics Software

Prepared By: Grant Rudow

August 29th, 2018

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1.1 Case Introduction

As accounting has developed through the years, firms have been competing to win over clients through improved efficiency and effectiveness. Data analytics has played a major role in these new processes, allowing the firms to gather wide arrays of data from multiple sources and input them into visualization software giving them a visual representation of what is going on throughout their client's business. By giving a client a visualization of the data, firms are able to more efficiently explain a situation to a client and then further advise them on the best strategy of approach. This case gives information on the benefits of new data analytics programs, and how they have altered the way accountants inform their clients on tax and audit decisions.

Google is widely known for their wide assortment of apps and software, in which, they make available for the public. The majority of schools and college campuses operate on the Google Drive platform, because it is available across all devices and is very user-friendly, offering many sharing functions which allow students to collaborate on projects. My research has shown that Google now offers the same capabilities to the data analytics community, through Google Fusion. I also learned about the importance of using data analytics to better predict the changes undergone in a client's business due to activities around the world.

1.2 Purpose of Tool

"Identify the purpose of Google Fusion and how it is used to make business decisions."

1. Google Fusion is a collaborative software where multiple people can upload data on activities occurring around the world. It is user friendly, meaning you don't need to understand computer coding in order to use it, allowing for anyone in a business to use it. Another advantage of Google Fusion is its ability to hold massive amounts of information on one data set. For example, during Hurricane Harvey, users were able to input data on road closures and flooding throughout the impacted area, which was then translated onto a map that showed a visualization of all the closures throughout the area. This allowed users to immediately see where it was safe to travel, and areas that were in need of assistance. The application of Google Fusion is widespread, from assisting in hurricane relief, to tracking viruses across the world, such as Zika, and even in to business, through tracking product returns. Businesses are able to harness the power of Google Fusion and visualize their data on many forms through the Google visualization software that is attached to Fusion. They can track tax rates across the world to better position themselves for tax purposes, or they can use a map to better predict fraud. The applications are far and wide throughout the business world, and as Google constantly updates the software the possibilities become endless.

1.3 Business Setting

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

1. Auditing
    a. It is important for an auditor to view all the information in a simple format, and all in one place. Google Fusion allows for multiple users to upload information into one data set, giving an auditor the ability to access the latest information at any given time, without fear that they are viewing outdated data.
    b. Google Fusion gives auditors the capability to track their company data and compare it to competitors to audit their results in real time. Through comparison, auditors are better able to analyze the data given to them and see if it is relevant to the current environment of the business.
    c. The auditors can visualize the cash flows of the company, which makes it easier to interpret, allowing them to be more efficient in the audit process, which in turn, saves their client time and money.
    d. Using graphs and tables, auditors can use Google Fusion to analyze trends across the world and compare it to their data points. For example, if there were a heat wave in the western United States, yet the sales of winter jackets showed an increase that month, an auditor would be able to see the two sets of data on the same graph and look further into the discrepancy

between weather and sales. This could help prevent fraud or mistakes when finishing the closing documents at the end of the month/year.

e. Finally, auditors can use Google Fusion to track revenue recognition. By using a visualization of their inventory flows, a company can track their sales and shipping across the world and correctly record revenue in the right period. By observing the changes in global inventory on one map and having access to all the data accompanying the map, auditors can automate much of the tracking process making their job more efficient and creating a more effective system to track inventory.

2. Tax Planning

   a. Google Fusion gives tax planners the ability to track real time tax rates from the local level to a global level. This allows a tax planner to analyze data and assess where the best location is to base a company out of, saving the company money by minimizing their tax expenses. The mapping visualization software Google Fusion offers gives tax planners access to all this information in one cohesive spot; saving them time, by eliminating a search through various data tables, which in turn saves their business money.

   b. Google Fusion also automates the tracking of bank accounts and brings them all together on to one dashboard. Previously, a tax planner had to go through multiple databases and make separate spreadsheets to manually input and track the changes in accounts through multiple entities. However, with Google Fusion, a single tax planner can now view real-time data from all of a company's accounts in one place. Again, saving the company time and money, by eliminating the manual input of data from multiple sources.

c. Finally, Google Fusion gives tax planners the ability to track company activity on a map, which they can then compare against the map of tax rates and better evaluate where to allocate product and company expenses. By seeing a real time view of flows of inventory, tax planners are more efficient at determining the best way to organize a company's assets.

1.4 Memo to Partners

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

1. As a company, I believe we should look into investing in Google Fusion as a resource to our business. It will not only give us the ability to be more efficient with our time, but it will also give us the security of knowing that we have up to date information on all our accounts and client projects. With Google Fusion, our auditing team will be more efficient when searching through trends, because they will be able to view all of the client's assets on one graph. This will also drastically decrease the chance of making mistakes, because the Google Fusion database will be using automated inputs directly from the client's accounts, rather than our employees manually inputting the numbers. Google Fusion will also be able to change the way our teams collaborate. Rather than working separately on different accounts, then coming together to try and compile multiple databases into one cohesive set of data; they would now be able to all work on the same data set at the same time. This gives them the ability to share information with each other much faster, saving them time and, in turn, saving our firm money.

   Along with our auditing team, our tax planners will also benefit from this investment, because they will be able to offer their clients real-time information on the best place to invest their assets in order to minimize tax expense. By using the visualization software in Google Fusion, the tax planners can create a map that associates all tax rates and tax laws from the local level, all the way to the global level, on a location basis. This will give them the ability to analyze and compare locations that will bring the clients tax expense to a minimum. It will also make it easier for our planners to inform their clients on the best option, because it is much more efficient to show them in a visualized way than pulling up a table full of numbers. In conclusion, I believe that Google Fusion will not only reduce time spent compiling data for both audit and tax planning, but it will also improve our effectiveness as a firm on all our client projects.

1.5 Sources

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CASE 2: Rocky Mountain

An Analysis of Excel and Proper Printing

Prepared By: Grant Rudow

September 11th, 2018

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2.1 Case Introduction

1. I expect to see all the accounts with balances on the balance sheet, since they will need to be included for the statement to balance out. Major assets include: Cash, Accounts Receivable, Inventories, Property and Equipment and Goodwill. Major liabilities include: Accounts Payable, Additional Paid-In Capital, Deferred Income/Income Taxes and Retained Earnings.
2. I learned a lot about using Excel while doing this case. Due to having very little instruction I was forced to use the Excel help guide and trial and error while creating the journal/statements. I learned the proper way to format financial statements within Excel, and how to get the sheets to print properly. This case was also a good refresher of journal entries and helped me understand them a bit more before the intermediate test on Friday.

2.2 General Journal

	Account	Beginning Balance	Purchase Inventory	Incur Factory Wages	Sell inventory for cash and on account	Pay for inventory	Collect Receivables	Incur SG&A (Cash and Payable)	Pay Wages	Receive Franchise Fee	Purchase PPE	Dividends Declared and Paid
	Cash and Cash Equivalents	1,253,947			17,000,000	(8,200,000)	4,100,000	(2,000,000)	(6,423,789)	125,000	(498,832)	(2,403,458)
	Accounts Recievable	4,229,733			5,000,000		(4,100,000)					
	Notes Receivable, current	-										
	Inventories	4,064,611	7,500,000	6,000,000	(14,000,000)							
	Deferred Income Taxes	369,197										
Dr.	Other	224,378										
	Property and Equipment, NET	5,253,598									498,832	
	Notes Receivable, less current portion	124,452										
	Goodwill, net	1,046,944										
	Intangible Assets, net	183,135										
	Other	91,057										
	Accounts Payable	1,074,643	7,500,000			(8,200,000)						
	Accrued Salaries and Wages	423,789		6,000,000					(6,423,789)			
	Other Accrued Expenses	531,941						3,300,000				
	Dividend Payable	598,986										3,709
	Deferred Income	142,000								125,000		
Cr.	Deferred Income Taxes	827,700										
	Common Stock	179,696										
	Additional Paid-In Capital	7,311,280										
	Retained Earnings	5,751,017										(2,407,167)
	Sales	-			22,000,000							
	Franchise and Royalty Fees	-										
	Costs of Sales	-			14,000,000							
	Franchise Costs	-										
	Sales & Marketing	-						1,505,431				
Dr.	General and Administative	-						2,044,569				
	Retail Operating	-						1,750,000				
	Depreciation and Amortization	-										
	Interest Income	-										
	Income Tax Expense	-										
	Assets + Liabilities = Equity	-	-	-	-	-	-	-	-	-	-	-

	Account	All other Transactions	**Unadjusted Trial Balance**	Adjust for inventory count	Record Depreciation	Wage accrual	Consultant's report	**Pre-Closing Trail Balance**	Closing Entry	**Post-Closing (Ending) Balance**
	Cash and Cash Equivalents	790,224	3,743,092					3,743,092		3,743,092
	Accounts Recievable	(702,207)	4,427,526					4,427,526		4,427,526
	Notes Receivable, current	91,059	91,059					91,059		91,059
	Inventories	(66,328)	3,498,283	(216,836)				3,281,447		3,281,447
	Deferred Income Taxes	92,052	461,249					461,249		461,249
Dr.	Other	(4,215)	220,163					220,163		220,163
	Property and Equipment, NET	132,859	5,885,289		(698,580)			5,186,709		5,186,709
	Notes Receivable, less current portion	139,198	263,650					263,650		263,650
	Goodwill, net		1,046,944					1,046,944		1,046,944
	Intangible Assets, net	(73,110)	110,025				-	110,025		110,025
	Other	(3,007)	88,050					88,050		88,050
	Accounts Payable	503,189	877,832					877,832		877,832
	Accrued Salaries and Wages		-			646,156		646,156		646,156
	Other Accrued Expenses	(2,885,413)	946,528					946,528		946,528
	Dividend Payable	(1)	602,694					602,694		602,694
	Deferred Income	(46,062)	220,938					220,938		220,938
Cr.	Deferred Income Taxes	66,729	894,429					894,429		894,429
	Common Stock	1,112	180,808				-	180,808		180,808
	Additional Paid-In Capital	315,322	7,626,602					7,626,602		7,626,602
	Retained Earnings		3,343,850					3,343,850	3,580,077	6,923,927
	Sales	944,017	22,944,017					22,944,017	(22,944,017)	-
	Franchise and Royalty Fees	5,492,531	5,492,531					5,492,531	(5,492,531)	-
	Costs of Sales	693,786	14,693,786	216,836				14,910,622	(14,910,622)	-
	Franchise Costs	1,499,477	1,499,477					1,499,477	(1,499,477)	-
	Sales & Marketing		1,505,431					1,505,431	(1,505,431)	-
Dr.	General and Administative	(261,622)	1,782,947			639,200		2,422,147	(2,422,147)	-
	Retail Operating		1,750,000			6,956		1,756,956	(1,756,956)	-
	Depreciation and Amortization		-		698,580			698,580	(698,580)	-
	Interest Income	(27,210)	(27,210)					(27,210)	27,210	-
	Income Tax Expense	2,090,468	2,090,468					2,090,468	(2,090,468)	-
	Assets + Liabilities = Equity	-	-	-	-	-	-	-		

2.3 Income Statement

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

2.4 Balance Sheet

Rocky Mountain Chocolate Factory, INC. As of Februrary 28, 2010 Balance Sheet			
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
Property and Equipment, Net		$	5,186,709
Other Assets			
Notes Receivable, less current portion	263,650		
Goodwill, net	1,046,944		
Intangible assets, net	110,025		
Other	88,050		
Total other assets			1,508,669
Total Assets		$	18,919,914
Liabilities and Stockholder's Equity			
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
Commitments and Contingencies			-
Stockholders' Equity			
Preferred stock, $.10 par value; 250,000 authorized; 0 shares issued and outstanding			
Series A Junior Participating Preferred Stock, authorized 50,000 shares			
Common stock	180,808		
Additional paid-in capital	7,626,602		
Retained Earnings	6,923,927		
Total Stockholders' Equity	$ 14,731,337		
Total Liabilities and Stockholders' Equity		$	18,919,914

2.5 Statement of Cashflow

1. Does not affect
2. Does not affect
3. Operating
4. Operating
5. Operating
6. Operating
7. Operating
8. Financing
9. Investing
10. Financing

CASE 3: Student Scenarios

Analyzing Three Student Scenarios

Prepared By: Grant Rudow

September 17th, 2018

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3.1 Case Introduction

We discussed three different scenarios that were based on true stories from Dr. D's past in this case. The first scenario portrayed a conversation between students trying to decide if they should take an accounting internship with a Big Four firm, and upon completing the internship, attend law school rather than returning as a full-time employee. The second scenario was about students who were talking about taking an internship/full-time job but leaving public accounting and becoming an investment banker/consultant before completing 3 years. Finally, the third scenario involved a student who was unhappy with living in Washington D.C. and was debating the best way to go about voicing his concerns and getting a transfer to Dallas.

This case has helped me discover things about my own career path and has cleared up a lot of worries about my future. Through the case and talking with Dr. D. after class, I finally decided on the location that I think I would fit best at and have got some new perplexing ideas of public accounting. Previously, I viewed public accounting as this big machine that one gets involved in for 2-3 years and then left as soon as one could. After listening to Dr. D. talk about it, I decided that it might be something that I could see myself staying in longer than I originally planned, depending on how much I enjoy it. This case took me from worrying a lot about my lack of plans for the future, to being excited about what's to come.

3.2 Scenario One

Set-Up: Student A is speaking to Student B in Conner about their internships. Student A begins to talk about how they are going to complete their 8-week internship with a Big Four firm, but once they are done, they will be attending a law school and hopefully working in an accounting role in a law firm.

Opinion:

In my opinion, there's no problem with wanting to go to a law school after getting an accounting degree or completing an internship. However, if one's goals are to do such, they need to let the recruiters know during the interview process about your plan. It's not fair to an employer to spend time and money recruiting and training just to find out that their prospect would want to quit within the first year and go to law school. If one tells them up front about it and they agree to it, then they have acknowledged one's plan, and it will remove the possibility of backlash from leaving. Although I agree that it's okay to let the recruiters know about your plans, I do not fully agree with the goal of going to law school. I understand that with a law degree one opens themselves to a high starting salary, but they also won't start working as soon as someone coming out of the accounting program at Ole Miss. By the time you've entered the work place after law school, your peers at accounting firms will have closed the difference in salary to a point where they all would be making roughly the same. Not to mention, coming out of law school, one will have even more student loans to pay off, so they will not really be making as much compensation as someone going straight into public accounting. At the end of the day, each person has a decision to make, and everyone has different desires in life, but in my opinion, the potential benefit of getting a law degree does not outweigh the costs of going to law school.

3.3 Scenario Two

Set-Up: Student A and B are talking with Student C about their goals for after college following their accounting internships. Student A and B were discussing about how they wanted to leave public accounting within their first couple years and move on to investment banking and consulting. Student C then questioned why they were getting accounting degrees and doing the accounting internship if they didn't want to do accounting as a career.

Opinion:

In some ways, I can relate to Students A and B in this situation because I can see why one would not want to stay in public accounting one's whole life. I also agree that getting an accounting degree from Ole Miss is a much better career move compared to getting a finance degree from the business school. However, if Students A and B have the end goal of leaving their respective accounting firm before their 3 years is up, I do not agree with their motives. I believe that if one makes a commitment to a firm, they need to see the commitment out. Even if the job is not one's favorite thing in the world, they should view it as a learning experience and use it to network with clients who could potentially hire you to do consulting or investment banking. There is nothing wrong with wanting to move out of public accounting as one goes through their career, but they cannot always be thinking about the next thing. One must sit down and take in as much information in their time at the firm so when they go on to their next endeavors, they will have a plethora of prior experiences to help you in decision making.

3.4 Scenario Three

Set-Up: Student A e-mails Dr. D. asking for advice on the best way to request a transfer of their offer letter from the Washington D.C. location to Dallas. For added context, he was only in Washington D.C. for his 6 to 8 week internship.

Opinion:

In my opinion, 6-8 weeks is not enough time to determine whether one likes the place they are living. Everyone will get homesick and want to move closer to their family, but that is just a fact of life and one must push through that pain in order to truly discover new places. Coming from someone who has moved across the country multiple times, it is not easy get accustomed to new places. One must force themselves to get out and explore the more uncommon places in the city and find where the locals go. Within one's first few weeks of living in Washington D.C. they may want to visit all the tourist attractions, but once they become a resident, they are not going to be spending every weekend at the Smithsonian or another attraction. One must ask their colleagues what they like to do in their free time and maybe fraternize with them one weekend and learn more about the city. All in all, it is important to be open-minded when moving to a new place because even if it isn't all one has dreamed of, they can still have an amazing time there. Also, if one looks at life from a big picture perspective, two to three years is not really that long, and it is probably good to be somewhere different for that period of time. Student A decided he did not want to live in Washington D.C. anymore and was looking to move back home to Dallas. I am against this decision because one's younger years in life are meant to be a time to get out and see the world and explore new places. By doing this, one will meet new people and take in all sorts of new ideas, which if they are still inclined, can bring back to their hometown later in life if that is where they truly want to end up. In conclusion, although I do understand how he could be homesick, I do not think it is appropriate to be requesting a transfer after only 6 to 8 weeks of living in a new place.

CASE 4: Generic Bank

An Analysis of Impairment Securities

Prepared By: Grant Rudow

October 2nd, 2018

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4.1 Case Introduction

In this case, I took the role of either a bank executive or an external auditor in order to decipher the decisions related to Generic Bank's debt security impairment and their securities portfolio as a whole. We used ASC 326-30 and other articles from the FASB codification in order to provide evidence to back up our determinations of what the bank should do. Throughout the case, I learned new accounting terminology and gained a basic understanding of impairments and debt securities. I was also introduced to the FASB codification as a whole for the first time which helped me relate the procedures I have learned in my classes to real-world laws and standards.

4.2 Question One

Question: "Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 20x3. Does Generic Bank have an impairment loss on the seven securities designated above in 20x2?"

Generic Bank does have an impairment loss on the seven securities designated above in year 20x2 because the total fair value estimate of the securities is a higher amount than the total amortized cost. Due to the $54,209,000 difference between total fair value and total amortized cost, we can rightfully conclude that there is an impairment on the securities account. However, according to ASC 326-30-35-4, impairments are calculated on an individual security level. So, security accounts 067 and 096 will not be recorded as an impairment because the fair value is greater than the amortized cost. This, in turn, means that it costs less for the company to hold on to the security than it does to sell the security. I understand why Joshua Winters is concerned about the sale of securities affecting the bank's assertions of having the intent and ability to hold the securities, but it is not uncommon for Generic Bank to sell securities during the period. Generic Bank has the full intent and ability to hold the unrealized loss securities until they recover their amortized cost, and they have this ability due to their multiple sources of liquidity throughout their portfolio.

4.3 Question Two

Question: "Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 20x3. Does Generic Bank have an impairment loss on securities other than the seven securities sold? If so, how would you determine the extent of the impairment?"

Generic Bank does not have an impairment loss on the securities excluding account 003, 015, 025, 030, and 076 from the aforementioned securities. Since they are not selling these other securities, it would not make sense for Generic Bank to recognize an impairment loss because they are holding them with the intent and ability to keep them at their amortized cost basis. Furthermore, the bank will recognize a credit loss in their books, however, this loss will not affect investors and their decisions because it will be excluded in their Pro-forma financial statements due to the loss being a one-time occurrence that is used to free up liquidity. According to ASC 326-30-35-15, if the bank were to recognize an impairment loss, they would have to re-value their investment portfolio which would cost more money than their loss is worth.

4.4 Question Three

Question: "Does your answer change if you assume the role of Heather Herring, the external auditor? Does your answer change if you assume the role of a bank regulator? What other factors might an external auditor or regulator consider in making their determination?"

If I were to assume the role of the external auditor, my answer would remain the same. According to Generic Bank, there are no credit losses present and the securities will be settled at less than the amortized cost basis. Which, according to FASB ASC Topic 450-20 and FASB ASC Topic 310-10, a loss only needs to be recorded if it is probable that a loss will be incurred, or the loss is reasonably estimated. Generic Bank has multiple ways to free up liquidity, so they are able to and have the intent to hold the securities at their fair value or through a decline until they return to fair value. According to ASU 2016-13, the aforementioned intentions of Generic Bank allow them to avoid recognizing an impairment. As a bank regulator, I would agree with the viewpoint of the external auditor in saying that Generic Bank does not have to recognize an impairment. Some factors that might weigh into an auditor or bank regulators determination revolve around Generic Bank following all rules and regulations. Their job is to check through all the books and determine if all the amounts match up and are within legal regulations, which according to the case, we can reasonably assume that all the totaled amounts are correct.

4.5 Question Four

Question: "How would your assessment of the existence of an impairment in both requirements 1 and 2 change if the securities sold had been collectively in a net gain position? What if all the securities sold were in gain positions?"

If Generic Bank were to experience a net gain position on the securities sold, I would still argue that they would not need to recognize an impairment loss. Without a credit loss, ASC 2016-13 does not require an impairment to be recognized since the fair value is well above the amortized cost. The change, however, would affect investor relations. Generic Bank would be able to include the net gain in their pro-forma financial statements, so this may encourage investors to invest more with Generic Bank because they can see a gain in their current investments. If all the securities were sold in gain positions, it would not make sense to recognize an impairment because there would be no credit loss on any of the securities. This, again, relates to ASC 2016-13 which supports the decision of not recognizing impairments on securities that are experiencing gain positions.

4.6 Question Five

Question: "Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 20x3. Does Generic Bank have an impairment loss on securities other than the seven securities sold?"

Generic Bank does not have an impairment loss on the securities even though they are only adequately capitalized. The decrease in accessibility of liquidity will affect the bank, but it does not change the difference in amortized cost and fair value. Each security will still maintain their original values, and in turn, the decision of whether to recognize an impairment will remain the same. By selling their debt securities the bank will reduce their risky assets which will then improve their capital ratios. As previously stated, the improvement of capital ratios will not affect the decision to recognize impairment because the bank is still holding the remaining securities with the intent and ability to maintain their amortized cost.

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CASE 5: City Selection

An Analysis of Cities to Live In

Prepared By: Grant Rudow

October 30^{th}, 2018

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5.1 Case Introduction

The goal of this case is to identify my number one and two cities that I am thinking about starting my career in. For each city I answered seventeen different questions, covering various topics. The case taught me a lot about what I am searching for in a future place of residence. Before, I hadn't really looked in depth at where I wanted to live and why I wanted to live there. Now, after going through my top two choices of cities and really analyzing all they have to offer, I am much more confident in my decision. I feel like I have a firm grasp on what it's going to be like living there, and after talking to a few more people and going to visit them, I won't be as worried about moving. I've moved homes consistently throughout my life, so moving isn't really a scary thought to me. However, this will be the first time I am moving completely on my own accord and deciding where to go based on my ambitions, rather than getting dragged along by my parents. It is a little concerning to be going off on my own and finally growing up, but at the same time it feels like a whole new door is opening in my life. I am excited to see where I will finally arrive in my future career.

5.2 Question One

"What is the population?"

New York, NY:

The population of New York City is 8.623 million people, which doesn't include the number of people commuting into the city during the day. According to the 2013 Census, the population of Manhattan increases from 1.6 million to 3.1 million people during work hours due to commuters from outside the city coming in to work. 8.6 million people will be a big change, but I think it will be good to experience a new region and so many different walks of life. New York is extremely diverse, and I believe I will become a more well-rounded individual if I live somewhere where I will be exposed to so many different viewpoints and cultures.

Miami, FL:

The population of Miami is 6.1 million people, ranking it the 7th largest metropolitan area in the United States. Along with New York, Miami is a melting pot of ideas and experiences. Although living in a big city can be intimidating, I think as a young professional it would be very beneficial to be living among so many people. The ability to make new connections and expand your network with peers you're living and working with is worth dealing with a little intimidation of a big city.

5.3 Question Two

"Describe the climate and seasonal fluctuations."

New York, NY:

New York City is considered a humid subtropical climate zone because of its close proximity to the rivers and oceans. The winters can dip to below freezing, but on average it stays a few degrees above freezing temperatures due to the water surrounding the city. Summer usually lasts from late May to late September, accompanied by a winter that lasts from December to March on average. October and April have the heaviest rainfall during the year due to cold-air damming from the Appalachian Mountains. All in all, the climate will be very different from Oxford, MS; after living most of my life in Minnesota I'm not too worried about it. The winters won't get nearly as cold as I was used to, and they won't last as long as the Midwest.

Miami, FL:

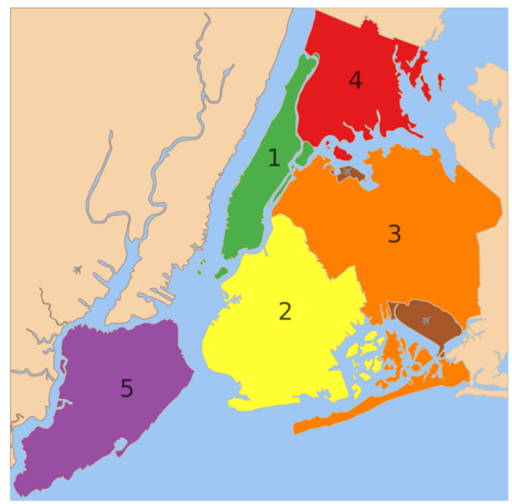
Miami is considered a tropical monsoon climate leading to hot and humid summers and short winters that are warm and drier. The summer days in Miami are usually very hot and humid with temperatures in the mid 80's to low 90's, however, the days cool off in the afternoon because of quick thunderstorms around the evening commute time. In fact, Miami reports an average of 80 thunderstorms a year which is more than the majority of cities throughout the U.S. Although the climate in Miami is very different from New York, I think it would be nice to live somewhere with endless summer and not have to worry about buying warm clothes for the winter. However, at the same time, not having four distinct seasons could get old after a few years.

5.4 Question Three

"Describe the city's topography, scenery and other geographic or geological features of the area in which the city is located."

<u>New York, NY:</u>

New York City is made up of five different boroughs with the main area being Manhattan which is where the majority of businesses are located along with the major tourist attractions, such as Times Square. Manhattan is the smallest and most densely populated of the five boroughs. The borough is contained on Manhattan island and sits at the mouth of the Hudson River. New York is an extremely urban area with skyscrapers towering into the skyline and smaller buildings sprinkled throughout the city. One of the key geographical features of the city is Central Park because it is the one area in the city where 778 acres of nature takes the forefront. The park features several natural-looking ponds and lakes, many large open meadows, and vast expanses of wooded land that all comes together to offer a place for people to escape the hustle and bustle of the city.



Miami, FL:

Miami is located between the Florida Everglades and Biscayne Bay and sits around 6 feet above sea level. The metropolitan area of Miami overlooks Biscayne Bay and the Atlantic Ocean. Right outside of the metropolitan area of Miami, people can enjoy time at South Beach and Miami Beach which sit within barrier reefs throughout Biscayne Bay. Miami is also in close proximity to the Bahamas and the Florida Keys, offering all different kinds of beaches to explore. Miami's beaches are much more suitable year-round compared to New York's due to the difference in weather. There isn't a park within the metro of Miami, but because of the geographic placement of Miami and the beaches surrounding the city, there are lots of places to enjoy nature.

5.5 Question Four

"What are the individual tax rates within the city, based on a starting salary of approximately $50,000/year?"

<u>New York, NY:</u>

In New York, the Federal, State, and Local tax rates accumulate to 18.02% of your paycheck. I calculated my after-tax salary on a semi-monthly rate and included deductions for FICA (7.65%). According to those assumed tax rates, I would be bringing home $1,547 on a semi-monthly basis, leading to a yearly take-home salary of roughly $37,128.

<u>Miami, FL:</u>

In Miami, there is no state income tax, so the only tax I would have to pay is 10.42% for Federal income tax. I calculated the semi-monthly rate the same as I did previously by including FICA (7.65%) in order to have a comparable number. After the calculation, I would be bringing home a semi-monthly salary of $1,707 which leads to a yearly take-home salary of $40,968.

5.6 Question Five

"What transportation hubs are in the city?"

<u>New York, NY:</u>

New York's airport system is one of the largest in the world, containing four major airports and many smaller ones around the area. New York City also offers one of the largest subway systems in the world, making it the preferred mode of transportation within the city. Grand Central Station and Penn Station are also hubs for the commuter train system that services the tri-state region. Other than the subway and commuter rail systems, people utilize taxi cabs and buses to get around the city as well. Another major transportation hub for the city is the Staten Island Ferry which annually carries over 19 million passengers.

<u>Miami, FL:</u>

Miami is home to a mass transit Metrorail system and a commuter rail line. Commuters can use these to travel into the metropolitan area from all around Southern Florida. Another major hub in Miami is the Port of Miami which is one of the largest cruise ship ports in the world with roughly 5 million passengers per year and a major cargo port. Miami also has an international airport that offers flights all over the world with multiple airlines.

5.7 Question Six

"What is the city's most prevalent industries?"

New York, NY:

1. Financial Services
2. Health Care
3. Professional and Technical Services
4. Retail Trade
5. Manufacturing
6. Educational Services

Miami, FL:

1. Tourism
2. Trade
3. International Freight
4. International Banking

5.8 Question Seven

"Describe the quality of the city's healthcare."

New York, NY:

New York City offers the largest public healthcare system in the U.S. and is ranked #15 in the nation in overall healthcare. There are 70 hospitals/care clinics within the 5 boroughs of the city, servicing the entire population of New York City.

Miami, FL:

The state of Florida ranks 48th in the nation for healthcare, going down in rankings over the last few years. Although the ranking is very low, there is a Mayo Clinic in Jacksonville, FL which is about a 5-hour drive from Miami. So, if I had any huge medical problems, I wouldn't have to travel outside of the state to seek help.

5.9 Question Eight

"What types of crime are common within the city and where are the locations within the city to avoid?"

New York, NY:

According to the FBI, New York City is the safest big city in the U.S. which I found surprising. Most of the time when I hear about New York in the news, it is related to some sort of crime being committed or a terrorist attempt. New York reduced crime by treating small-crime with the same aggressiveness as high-profile crime. In other words, by going after shoplifters in the same way they went after a mugger, the NYPD was able to set a precedent and reduce crime in the area. However, like every big city, there are places to avoid and these include Vinegar Hill (Brooklyn), Downtown Brooklyn, Times Square (Manhattan), Meat Packing District (Manhattan), Koreatown (Manhattan), Port Morris (Manhattan), and the Garment District (Manhattan).

Miami, FL:

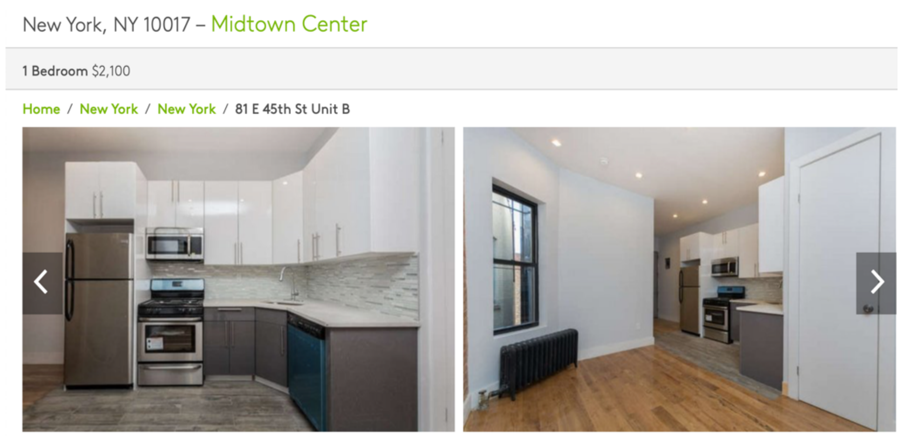
Miami has one of the highest violent crime rates out of all cities in the U.S., both large and small. The crime rate has been going down since the 80's, but due to shows like Miami Vice and CSI Miami, there has been a bad rep surrounding the city. The places to avoid in the city include Liberty City, Overtown, West Coconut Grove, Little Haiti, and parts of Little Havana.

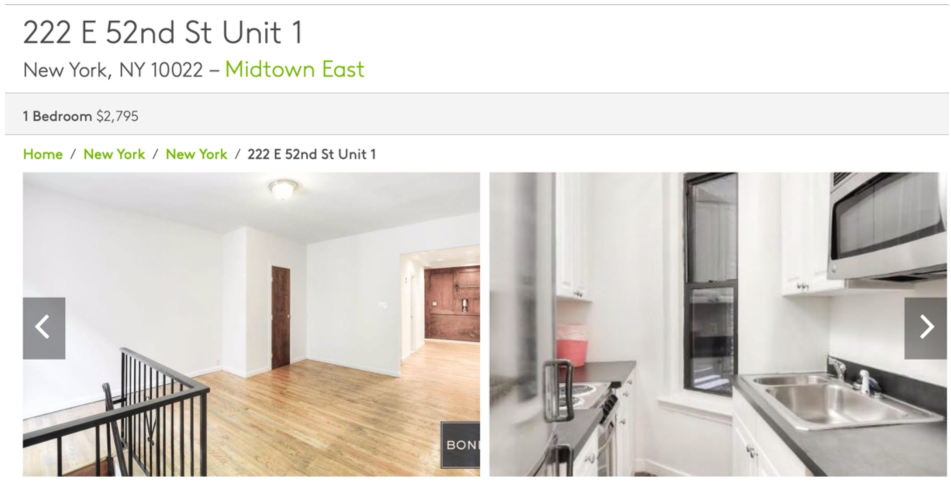
5.10 Question Nine

"Based on where you see yourself living for the first three years, how much rent do you expect to pay?"

<u>New York, NY:</u>

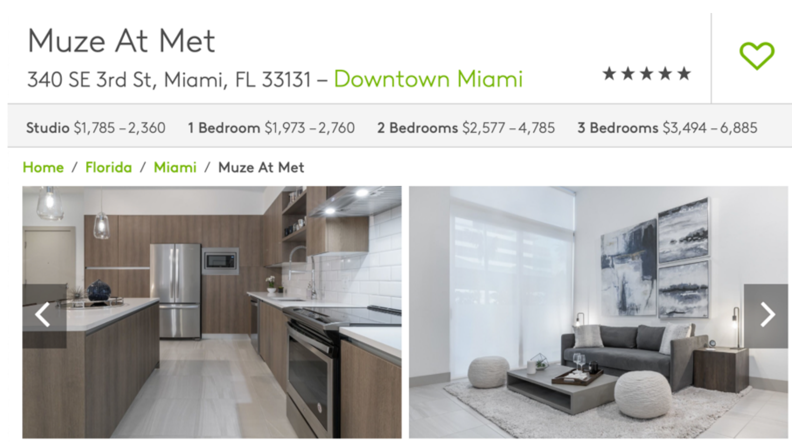
I am expecting to pay between $1,000 to $1,800 a month in rent, depending on how the rates change. As of now, I found an apartment that is within walking distance of all the Big 4 offices. I am planning on getting a roommate or two in order to keep the cost down. I attached one photo of an apartment that would cost $1,050 a month if I had a roommate, and it is close to all the offices. There is also a second picture of an apartment that would cost $1,400 a month. My first couple years in the city are going to be spent in a small apartment, but I realized that I won't be spending all that much time at home. Therefore, it isn't the end of the world to have a small apartment. Living in New York would cut car expenses out of my budget and eliminate the need for parking at my apartment. The apartments in New York don't offer many amenities, so I wouldn't have access to a pool, fitness facilities, etc which would lead to some additional costs in my budget.



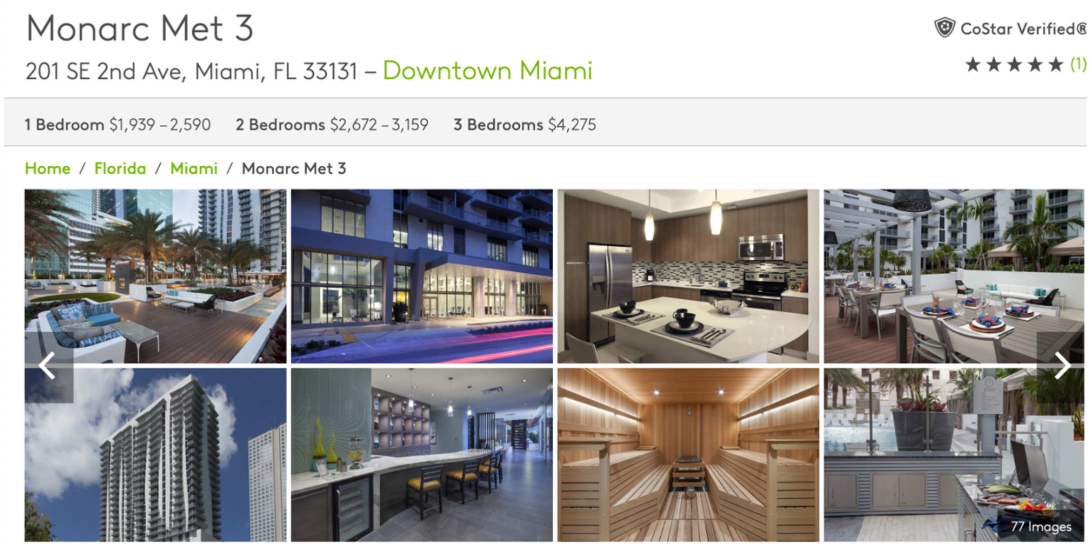


<u>Miami, FL:</u>

Living in Miami, I am expecting to pay around $1,000 a month in rent with a roommate. I found two apartments that are across the street from KPMG, Deloitte, PwC, and just a short drive to EY. Most apartment buildings in Miami are very modern and new looking, so paying $1,000 wouldn't go to waste. There are also many amenities available in both apartments I found, ranging from a pool, workout facilities, to an assigned covered parking spot. In both cities, I think it is worth paying more in rent to reduce, or even eliminate, a commute by having the ability to walk to the office instead of paying for some other type of transportation. I would also work with a realtor



when picking a spot to live and finding a roommate to split the cost with.



5.11 Question Ten

"What is the typical mode of commuting? What are your likely commute times?"

<u>New York, NY:</u>

I'm hoping to live in Manhattan, so I would most likely take the subway or walk to work. The fare for a subway ride is $2.75, or I have the option to buy an annual pass for $121. If I needed to drive, I could take Uber or Lyft, but the prices would vary depending on the time of day and the current demand.

<u>Miami, FL:</u>

In Miami, I would be living in the metro area in close proximity to the offices. I would be able to walk to work. Unlike New York, I would have my car in Miami, so if it were raining or too hot to make the walk, I could drive into the office, however, I would have to leave more time for the commute due to the traffic.

5.12 Question Eleven

“Where will you do your grocery shopping?”

New York, NY:

Shopping in New York will be a lot different from what I’ve grown up with. There aren’t very many big chain stores in the city, so I would find smaller grocery stores near my apartment and most likely have to shop around at a few different stores in order to find everything I would need. It will be more expensive to buy groceries, but in the long run, I will save money cooking my meals at home compared to going out to eat twice a day, every day. There are also a few grocery delivery companies that allow you to order the items you want online and have them delivered to your door. So, if I were running short on time one week, I would have that option.

Miami, FL:

In Miami, I would be able to shop at larger grocery chains such as Publix, Whole Foods, and Trader Joes. Due to the access to larger stores, the prices would be a lot cheaper in comparison to New York and going grocery shopping would be a lot less of a hassle.

5.13 Question Twelve

"How will you do your laundry?"

New York, NY:

I decided it will be worth it to pay a little extra for an apartment that includes a washer and dryer within the unit. That way it is more convenient to do laundry and won't require me to take my clothes to a laundromat. It might also be a possibility to look into a laundry service that would pick-up and delivery my clothes depending on if my budget would allow.

Miami, FL:

Along with New York, I decided it's worth it to pay a little extra in rent to have the convenience of having a washer and dryer in my apartment. I will be working a lot of hours in my first few years out of school, so it's not worth it to lose time walking my clothes to a laundromat when I could just add a little to my rent and do laundry in my apartment.

5.14 Question Thirteen

"Name at least three civic, religious, or charitable organizations you would like to be active in for each city."

New York, NY:

1. BUILD NYC
    a. This is a mentoring program that helps under-resourced teenagers nurture entrepreneurial ideas. I would be able to help them pursue their aspirations that they normally wouldn't have the chance or knowledge to do on their own.
2. 06 United Football Club
    a. I would be able to help coach soccer to kids age 5-15 and also mentor them outside of practice.
3. I would also like to find a church to go to, however, it would take some time to go visit each one and find a place I liked. There are lots of options in Manhattan and the rest of the city, so I'm sure I'd be able to find a place I like.

Miami, FL:

1. Big Brothers Big Sisters Miami
    a. I would have the opportunity to mentor a "little brother" and help them out with their lives. I like the idea of mentoring because I feel like I've learned a lot in my experiences that I

have had, and it would be awesome to pass that on to younger children.

2. First Tee – Miami

    a. I would be able to teach kids how to golf and give them advice on things other than golf. I think it would be a great opportunity to spend time with kids and escape the corporate world for a bit.

3. Pelican Harbor Seabird Station

    a. I think this would be a unique opportunity that I wouldn’t normally be able to participate in. Through the Seabird Station, I would help rescue, rehabilitate, and release sick/injured pelicans and other seabirds.

5.15 Question Fourteen

"What are the sports, entertainment, or recreational activities that you would be most likely to engage in within the city?"

New York, NY:

From professional sports to Broadway shows, New York City has anything you could imagine. With 45,000 restaurants, one could eat somewhere new every day and still not go to every place. There is a sports team from all the major sports and leagues in New York, ranging from baseball, basketball, football, hockey, and more. I don't think I would ever get tired of the vast array that the city has to offer, and it would be amazing as a young professional to have the opportunity to check out so many different forms of entertainment. There are constantly new shows and concerts coming into the city, so if one's budget allows, they could go to a different event every night. If I get the chance to go to New York, I hope to experience as much as possible and make the most of my time in such an inviting and enthralling city.

Miami, FL:

Miami isn't quite as big as New York, but there are still many things to do throughout the city. One can go hang out at one of the many restaurants on South Beach, or one could enjoy a drink while sitting on the beach. Miami also offers professional basketball, baseball, football, and soccer, along with many minor league teams. The city is well known for the nightlife, with many bars, concerts, and multiple music festivals per year. Also, due to Miami's close proximity to the Florida Keys, I could take a weekend road trip to the beaches there.

5.16 Question Fifteen

"What are the modes of traveling back to your hometown from this city? What is the average cost you'd incur for each trip back home?"

New York, NY:

In order to visit my family, I would need to fly down to Orlando, FL. Luckily, since New York has so many airports, one can find pretty cheap tickets ranging between $150-300 depending on the time of year.

Miami, FL:

If I were to visit my family, I would be able to drive up to Orlando, FL. The drive is about three and a half hours, totaling 236 miles. Based on my car's gas mileage, and the current price of gas, it would cost around $50 in gas to get home. If I didn't have time to make the drive, I could also fly from Miami to Orlando for about $150-250.

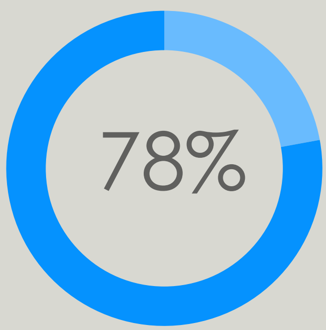
5.17 Question Sixteen

"Based on your findings, develop a monthly operating budget for each city for Year 2, assuming that your annual salary is $60,000."

New York, NY:

New York - Monthly Budget

Percentage of Income Spent



Summary

TOTAL MONTHLY INCOME

$3,595

TOTAL MONTHLY EXPENSES

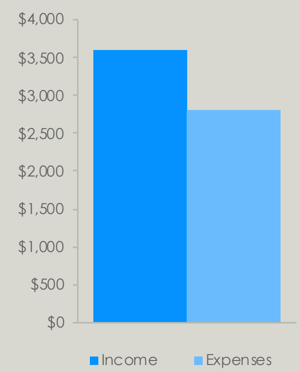
$2,800

TOTAL MONTHLY SAVINGS

$719

CASH BALANCE

$76



Monthly Income

ITEM	AMOUNT
Income Source 1	$3,595.00

Monthly Expenses

ITEM	DUE DATE	AMOUNT
Rent/mortgage	[Date]	$1,300.00
Utilities	[Date]	$175.00
Internet	[Date]	$30.00
Cell phone	[Date]	$45.00
Groceries	[Date]	$500.00
Health Care	[Date]	$250.00
Personal care	[Date]	$200.00
Entertainment	[Date]	$200.00
Miscellaneous	[Date]	$100.00

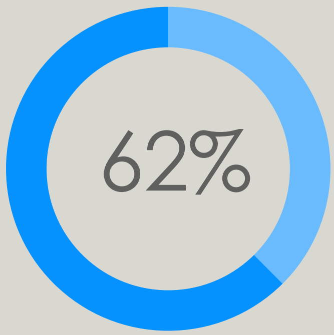
Monthly Savings

DATE	AMOUNT
[Date]	$719.00

Miami, FL:

Miami - Monthly Budget

Percentage of Income Spent



Summary

TOTAL MONTHLY INCOME

$4,000

TOTAL MONTHLY EXPENSES

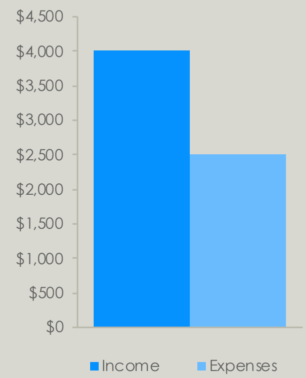
$2,498

TOTAL MONTHLY SAVINGS

$800

CASH BALANCE

$702



Monthly Income

ITEM	AMOUNT
Income Source 1	$4,000.00

Monthly Expenses

ITEM	DUE DATE	AMOUNT
Rent/mortgage		$1,000.00
Utilities		$75.00
Internet		$30.00
Cell phone		$45.00
Groceries		$500.00
Auto expenses		$120.00
Auto Insurance		$78.00
Personal care		$250.00
Entertainment		$300.00
Miscellaneous		$100.00

Monthly Savings

DATE	AMOUNT
	$800.00

5.18 Question Seventeen

"Determine whether you still want to live in both cities, and if so, which one is your preferred city and why?"

After analyzing both cities and going into detail about what it would be like to live there, I've decided that I prefer New York over Miami. Although New York will cost more, I think that would be more beneficial for my career to go somewhere with so many different options. Working in the financial instruments industry interests me a lot, and New York is the hub of the entire industry. The clients I would be exposed to in New York are also a big reason I would like to go there. New York City is home to so many Fortune 500 companies and getting the opportunity to work with them at such a young age is hard to pass up on. I also believe that when someone is fresh out of college it is important to go somewhere and experience something new, and since I have family in Florida, I think I need to get out and go somewhere I've never lived before. Miami had many positive aspects that I did like, but coming out of college, I think I would enjoy New York more.

CASE 6: WorldCom

An Analysis of Capitalized Costs and Earnings Quality

Prepared By: Grant Rudow

November 13th, 2018

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6.1 Case Introduction

In this case, we studied the strategy that WorldCom's CFO, Scott Sullivan, took in order to improve the numbers on their books. Sullivan decided that it would be beneficial to capitalize costs that should have been expensed in order improve the bottom line of the business. By capitalizing the costs, WorldCom's books showed higher net income and a higher balance of assets than they should have. The WorldCom case shows how much of an impact a single journal entry can have on not only a company, but all the employees that work for the company. Thousands of people lost their jobs, and even more lost money they had invested in WorldCom stock. In conclusion, I think it was very beneficial to learn about WorldCom and see a real-life example of how ethical decision making can directly affect a company.

6.2 Question A

Question: "FASB Statement of Concepts No. 6, Elements of Financial Sates, describes the building blocks with which financial statements are constructed."

A.) Explain, in your own words, how SCON 6 defines "assets" and "expense."

SCON 6 defines both assets and expenses related to operations and economic benefits. Assets can be defined as a past transaction or entity that has a high chance of providing a future economic benefit, this may include buildings, land, equipment, etc. Expenses are then defined as outflows of cash/liabilities related to an asset or entity's ongoing major or central operations. This may include depreciation expense, utilities expense, rent expense, etc.

B.) In general, when should costs be expensed and when should they be capitalized as assets?

Costs are expected to be expensed when they offer no improvement to an asset. These costs fall into routine maintenance of an asset that will keep the asset in the same state it was before the costs were incurred. In turn, costs should be capitalized when they offer an improvement to an asset, not an ongoing activity. For example, if a company were to buy a new motor for a machine on their assembly line, and it improved the efficiency of said machine, the cost of the new motor would be capitalized.

6.3 Question B

Question: "What becomes of "costs" after their initial capitalization? Describe, in general terms, how the balance sheet and the income statement are affected by a decision to capitalize a given cost."

After the initial capitalization of a cost, it will no longer be considered an expense, rather it will become part of the asset it is capitalized against. Due to capitalization, a company will show higher total assets on their balance sheet, which in turn leads to higher net income. By capitalizing costs, a company can smooth out their income over time, leading to less variability in their income. However, companies that expense the costs rather than capitalize them will show lower profitability initially, but in later years will display a higher profitability.

6.4 Question C

Question: "Refer to WorldCom's statement of operations. What did the company report as line costs for the year ended December 31, 2001? Prepare the journal entry to record these transactions for the year. Explain in your own words, what these "line costs" are."

WorldCom stated that their line cost for December 31, 2001 were $14,739,000,000

Dr. Line Cost Expense	$14,739,000,000	
Cr. Cash		$14,739,000,000

In the case, line costs are charges for access and transportation of the lines that WorldCom used to run their telecommunications program.

6.5 Question D

Question: "Refer to the Wall Street Journal article. Describe the types of costs that were improperly capitalized at WorldCom. Explain, in your own words, what transactions give rise to these costs. Do these costs meet your definition of assets in part A above?"

WorldCom improperly capitalized the $3.1 billion worth of "line costs." These costs were capitalized even though they were operating leases, which, under standard accounting principles, are required to be expensed. Rather than expensing the operating lease as they were incurred, Sullivan decided to amortize them over the 10-year period they were used, which would have been proper accounting if the "line costs" were eligible to be capitalized. Due to the definition of an asset being an item that provides a company continued economic benefit, WorldCom's "line costs" do not meet this standard, and thus should have been recorded as an expense.

6.6 Question E

Question: "Prepare a single journal entry to record the improperly capitalized line costs of $3.055 billion for the year. Where did these costs appear on the balance sheet? Where on the statement of cash flows?"

Dr. Property, Plant, and Equipment	$3,055,000,000	
Cr. Line Cost Expense		$3,055,000,000

The costs on the balance sheet appear as $3,055,000,000 in Property, Plant, and Equipment. Due to the capitalization of line cost expense, the $3,055,000,000 would show on the statement of cashflows as a capital expenditure.

6.7 Question F

Question: “Assume that WorldCom planned to depreciate these capitalized costs over the midpoint of the range for transmission equipment as disclosed in note 1. Further assume that depreciation begins in the quarter that assets are acquired. Calculate the related depreciation expense for 2001. Prepare the journal entry to record this depreciation.”

Quarter	Dollar Amount	Depreciable Base	Segment of Year	Depreciation Expense
1	$771,000,000	$35,045,455	$\frac{12}{12}$	$35,045,455
2	$610,000,000	$27,727,273	$\frac{9}{12}$	$20,795,455
3	$743,000,000	$33,772,727	$\frac{6}{12}$	$16,886,364
4	$931,000,000	$42,318,182	$\frac{3}{12}$	$10,579,545
Total				**$83,306,818**

Dr. Depreciation Expense	$83,306,818
Cr. Accumulated Depreciation	$83,306,818

The depreciation expense was found by using the quarterly capitalized amounts and dividing them by the midpoint of the useful life (22 years), which gave the depreciable base. I then took the depreciable base and multiplied it by the months it was used to find the allocated depreciation expense for the year. After totaling the four quarterly installments of depreciation expense, I found a total depreciation expense of $83,306,818.

6.8 Question G

Question: "Use your answers to parts e and f above, to determine what WorldCom's net income would have been in 2001 had line-costs not been improperly capitalized. Use 35% as an approximation of WorldCom's 2001 marginal income tax rate, in your calculations. State any other assumptions you make. Is the difference in net income material?"

Income Before Taxes, unadjusted		$2,939,000,000
ADD: Accumulated Depreciation		83,306,818
LESS: Capitalized Line Cost		(3,055,000,000)
Loss Before Taxes, adjusted	(578,693,182)	
Income Tax Benefit	202,542,614	
Minority Interest		35,000,000
Net Loss After Taxes, adjusted		**$(341,150,568)**

This is material, because the original statement showed a net income of $1,501,000,000, however, WorldCom should have showed a loss of $341,150,568.

CASE 7: Starbucks

An Analysis of Financial Statements

Prepared By: Grant Rudow

March 1st, 2019

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7.1 Case Introduction

In this case, we analyzed Starbucks' financial reporting for the fiscal years 2012 and 2013. After acquiring the excel document of their financial reports from their online 10-K filing with the SEC, we were able to create common size statements to better analyze the company. I learned many things while doing this case, but one of the things that stood out the most was their revenue recognition principles. Their multiple revenue streams forces Starbucks to have a variety of different ways to recognize the revenue, and in my opinion that could lead to many mistakes and misjudgments. However, through their external audit, Deloitte affirmed that Starbucks had no material mistakes in their financial reporting. I thought it was very interesting to look at a real company's financial statements and the attached notes, because we don't really see full consolidated statements in our textbooks when learning about financial accounting.

7.2 Question A

Question: “What is the nature of Starbucks’s business? That is, based on what you know about the company and on the accompanying financial statements, how does Starbucks make money?”

Starbucks is a coffee distributor/seller, with over 20,000 brick and mortar coffee shops in 62 countries around the world. In the coffee shops Starbucks sells a wide range of products including black coffee, designer coffee drinks, mugs, clothing, bakery items, a small lunch menu, etc. It seems like every other day Starbucks is introducing a new drink or new food item to their menu that keeps their customers always coming back for more. Through the deep brand loyalty and name recognition that Starbucks has garnered over the years, they have been able to expand into licensed products. Now customers are able to buy their favorite Starbucks roast in Keurig cup form, allowing them to make their own coffee in the comfort of home, all while maintaining the Starbucks quality. Starbucks has done an excellent job of expanding into markets and creating a true cult following behind their product. College students everywhere frequent their local Starbucks shops and are very willing to pay $5 plus for their drink to get them through their study session.

7.3 Question B

Question: "What financial statements are commonly prepared for external reporting purposes? What titles does Starbucks give these statements? What does "consolidated" mean?"

GAAP requires that all organizations produce the following four statements:

1. Balance Sheet
    a. Starbucks Title: "Consolidated Balance Sheets"
2. Income Statement
    a. Starbucks Title: "Consolidated Statements of Earnings"
3. Statement of Retained Earnings/Statement of Owner's Equity
    a. Starbucks Title: "Consolidated Statements of Equity"
4. Statement of Cash Flows
    a. Starbucks Title: "Consolidated Statements of Cash Flows"

A consolidated statement is a financial statement that includes the parent company and all subsidiaries. These statements make it easier for a company, such as Starbucks, to display all their assets, liabilities, equity, income, expenses, and cash flows under one set of statements, rather than making a user search through and combine multiple statements from all the subsidiaries.

7.4 Question C

Question: "How often do publicly traded corporations typically prepare financial statements for external reporting purposes?"

> Publicly traded corporations are required by the SEC to prepare financial statements at the end of each quarter. However, it is hard for companies of that size to get their financial statements done on the day of the quarter end, so the SEC has given them 45 days, after the end of the quarter to complete and produce the financial statements. At year end, they are given a longer period of 90 days to complete their financial statements.

7.5 Question D

Question: "Who is responsible for the financial statements? Discuss the potential users of the Starbucks financial statements and the type of information they are likely interest in?"

The company's internal accounting team is responsible for preparing financial statements. The potential users of Starbucks financial statements include, but aren't limited to, Starbucks internal management teams, banks (when making decisions about loans), external investors, and the SEC. The internal management team would use the financial statements to judge the period's profitability and efficiency, and where their space for improvements lie. The external users would use the reports to judge their decisions surrounding loaning money and investing in the company. Outside investors want to be certain they aren't investing in a company that is losing money or could be predicted to lose money based on the liabilities they hold on their balance sheet.

7.6 Question E

Question: “Who are Starbucks’ external auditors? Describe the two “opinion” letters that Starbucks received in 2013. In your own words, what do these opinions mean? Why are both opinions dated several months after Starbucks’ year-end?”

Starbucks is externally audited by Deloitte. Starbucks received two different “opinion” letters from Deloitte after the audit was completed. The first “opinion” was sent to confirm that Deloitte had gone through all their audit tests and found that there were no issues relating to the GAAP principles required of all companies, and that the statements fairly presented Starbucks’ financials for the year. At the end of the first “opinion,” Deloitte lets the Board of Directors know that they also audited the company’s internal controls over financing and found they needed to be looked into more. The second “opinion” covers the issues with internal controls. Deloitte states in the second article the three policies and procedures a company’s internal controls should cover. They state that in their opinion, Starbucks maintained all proper policies and procedures during the year for effective internal controls over financial reporting. The two opinions cannot be completed until the audit has been completed. Since it takes a considerable amount of time to complete the audit after year-end, the “opinion” letters must be sent a couple months after year-end, upon the completion of the audit.

7.7 Question F

Question: "Use a spreadsheet to construct common-size income statements and balance sheets for 2013 and 2012."

Consolidated Common-Size Income Statement

	2013	**2012**
Net revenues:		
Company-operated stores	79.19%	70.74%
Licensed stores	9.14%	8.13%
CPG, foodservice and other	11.67%	10.44%
Total net revenues	100.00%	89.31%
Cost of sales including occupancy costs	42.86%	39.04%
Store operating expenses	28.78%	26.31%
Other operating expenses	3.07%	2.89%
Depreciation and amortization expenses	4.17%	3.70%
General and administrative expenses	6.30%	5.38%
Litigation charge	18.70%	0.00%
Total operating expenses	103.87%	77.31%
Gain on sale of properties	0.00%	0.00%
Income from equity investees	1.69%	1.41%
Operating income	-2.19%	13.41%
Interest income and other, net	0.83%	0.63%
Interest expense	-0.19%	-0.22%
Earnings before income taxes	-1.54%	13.83%
Income taxes	-1.60%	4.53%
Net earnings including noncontrolling interests	0.06%	9.30%
Net earnings attributable to noncontrolling interest	0.00%	0.01%
Net earnings attributable to Starbucks	**0.06%**	**9.29%**

Weighted average shares outstanding:

Basic	$ 749.30	$ 754.40
Diluted	$ 762.30	$ 773.00
Cash dividends declared per share	$ 0.89	$ 0.72

Consolidated Common-Size Balance Sheet

	2013	2012
Current assets:		
Cash and cash equivalents	22.36%	14.46%
Short-term investments	5.71%	10.32%
Accounts receivable, net	4.87%	5.91%
Inventories	9.65%	15.10%
Prepaid expenses and other current assets	2.50%	2.39%
Deferred income taxes, net	2.41%	2.90%
Total current assets	47.51%	51.09%
Long-term investments	0.51%	1.41%
Equity and cost investments	4.31%	5.60%
Property, plant and equipment, net	27.79%	32.35%
Deferred income taxes, net	8.40%	1.18%
Other assets	1.61%	1.76%
Other intangible assets	2.39%	1.75%
Goodwill	7.49%	4.86%
TOTAL ASSETS	**100.00%**	**100.00%**
Current liabilities:		
Accounts payable	4.27%	4.84%
Accrued litigation charge	24.17%	0.00%
Accrued liabilities	11.02%	13.79%
Insurance reserves	1.55%	2.04%
Deferred revenue	5.68%	6.21%
Total current liabilities	46.69%	26.89%
Long-term debt	11.28%	6.69%
Other long-term liabilities	3.11%	4.20%
Total liabilities	**61.08%**	**37.77%**
Shareholders' equity:		

Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0.01%	0.01%
Additional paid-in capital	2.45%	0.48%
Retained earnings	35.86%	61.40%
Accumulated other comprehensive income	0.58%	0.28%
Total shareholders' equity	38.90%	62.16%
Noncontrolling interests	0.02%	0.07%
Total equity	**38.92%**	**62.23%**
TOTAL LIABILITIES AND EQUITY	**100.00%**	**100.00%**

7.8 Question G

Question: “Refer to Starbucks’ balance sheet for fiscal 2013 (FYE September 29, 2013)”

i.) “What are Starbucks’ major assets? Calculate the proportion of short-term and long-term assets for 2013. Does this seem appropriate for a company such as Starbucks?”

Starbucks’ major assets include:

1. Cash and Cash Equivalents
2. Inventory
3. Property, Plant, and Equipment, net

Short-Term Assets = 47.1%

Long-Term Assets = 52.49%

These proportions are appropriate for a company such as Starbucks, because they have a lot of infrastructure contained in their coffee shops and all the accompanying machinery, which would lead to a high Property, Plant, and Equipment balance. Starbucks manufactures and sells coffee, which would in turn lead to a high inventory balance. Finally, since they are a retail/consumer-based company, they must carry a high balance of cash. This also shows that they are a liquid company, since they carry a small amount of liability in comparison to their cash balance.

ii.) “In general, what are intangible assets? What is goodwill? What specific intangible assets might Starbucks have?”

Intangible assets are assets that do not have physical qualities. This includes licenses, patents, franchises, etc. Goodwill is the value created when the purchase price is higher than the fair market value of an acquisition. Starbucks has a broad range of intangible assets, including, acquired and reacquired rights, trade secrets, licensing agreements, contract-based patents, copyrights, trade names, and trademarks.

iii.) “How is Starbucks financed? What proportion of total financing comes from non-owners?”

Starbucks financing is based on growth in revenues and outside investors. According to their financial statements approximately 22 percent of their total financing comes from non-owners, which is contained in their long-term debt.

7.9 Question H

Question: "Refer to Starbucks' statement of earnings for fiscal 2013 and to the common-sized income statement you developed in part f."

i.) "Review the revenue recognition policies of Starbucks discussed in Note 1. Does Starbucks record revenue when they receive cash from their customers or do they follow a different rubric? How does Starbucks record revenue on stored value cards? What challenges in measuring revenue do you observe? That is, are there any significant judgements management needs to make in record sales revenue at Starbucks?"

Starbucks recognizes all in-store sales revenue at the point of sale, meaning as soon as the cash is received from the customer Starbucks inputs it as revenue on their books. Revenue derived from store value cards is not recognized until the card has been redeemed, or when the likelihood of redemption (based on historical experience) is deemed to be remote. Starbucks has many different sources of revenue, along with multiple recognition principles, which could pose a challenge in collecting information on total revenues at a given time. Management would need to make judgements on how they define "substantial performance" in order to recognize revenues from newly licensed store. This could be aided by instituting a policy that defines when a store has reached "substantial performance" based on a set criterion.

ii.) "What are Starbucks' major expenses?"

Major Expenses:

1. Operating Expense
2. General & Administrative Expense
3. Litigation Charge

iii.) “Were there any significant changes in the cost structure during the most recent year?”

The significant change to Starbucks’ cost structure was the addition of the litigation charge which was equivalent to 18.7 percent of the total revenues for the year.

iv.) “In fiscal 2013, Starbucks separately reported a litigation charge and included it in operating income. Why didn’t the company just include this amount within the line item for general and administrative expenses? Why is it an operating expense?”

Starbucks had to include the litigation charge as an operating expense, because it was considered a legal fee which falls under the operating category. The litigation was directly linked to their operations, not there general and administrative expenses.

v.) “Was the company profitable during 2013? During 2012? Explain your definition of “profitable.””

In my opinion, Starbucks was profitable in 2013 and 2012, even though they reported a net loss in operating income for 2013. Both 2012 and 2013 had positive net earnings attributable to Starbucks, which I would define as the net income that Starbucks received. 2013 showed much smaller net earnings than 2012, but it was still a positive amount which leads me to assume that they were profitable, even though they had to pay the litigation charge.

7.10 Question I

Question: "Refer to Starbucks' fiscal 2013 statement of cash flows."

i.) "Compare Starbucks' net earnings to net cash provided by operating activities and explain the difference."

Starbucks shows a large increase in net cash provided by operating activities in 2013, compared to 2012. Due to the litigation charge, Starbucks was able to use their loss of income to defer a large portion of their taxes that they had not previously been able to do. This in turn led to the increase of net cash provided by operating activities and explains why it's different when compared to net earnings. Net earnings don't show the deferral of taxes, and thus, shows a much smaller amount in comparison to the statement of cash flows.

ii.) "How much cash did Starbucks use for expenditures for property, plant and equipment during fiscal 2013?"

Starbucks used approximately $1,151 billion on expenditures for property, plant and equipment during the fiscal year 2013. In 2013, Starbucks invested in roasting equipment, and invested in some additions to fixtures and furniture which both led to the increase of expenditures from 2012 to 2013.

iii.) "What amount of dividends did Starbucks pay during the year? How does this amount compare to the amount of dividends declared as shown in the statement of equity?"

Starbucks paid $195,800,000 in dividends at the end of the fiscal year 2013. This is different from the $668,600,000 dividends declared on their statement of equity for the fiscal year 2013.

7.11 Question J

Question: “Several notes to the financial statements refer to the use of “estimates.” Which accounts on Starbucks’ balance sheet require estimates? Are any accounts estimate-free?”

Accounts that require estimates:

- Short-term investments
- Accounts receivables
- Inventories
- Deferred income taxes
- Long-term investments
- Equity and cost investments
- Property, plant and equipment
- Other assets
- Other intangible assets
- Goodwill
- Accrued Litigation charge
- Long-term debt
- Retained Earnings

Accounts that are free of estimates:

- Cash and cash equivalents
- Prepaid expenses and other current assets
- Accounts payable
- Common stock outstanding

CASE 8: BP Oil

An Analysis of Possible Contingent Liabilities

Prepared By: Grant Rudow

April 1st, 2019

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8.1 Case Introduction

In this case, we studied the effects of the BP oil spill in 2010. I looked into the affects it had on contingent liabilities on BP's financial statements, and also analyzed the product warranties from BP's perspective and GE Oil and Gas' perspective. I learned a lot about contingent liabilities while writing this case. One key take away is how hard it is for accountants and auditors to estimate contingencies while the event is taking place. Since there aren't' many events like major oil spills, BP had no precedent to base their estimates on, making the process difficult. They were also slammed with penalties and fines throughout the recovery process of the Gulf, and they are still facing litigation charges from industries and individuals who were impacted by the spill. All in all, I think this case was very helpful in expanding my knowledge of contingent liabilities in a real-world setting, whether it be their relation to product warranties or unforeseen disasters.

8.2 Question A

Question: **"**What is a contingent liability? Explain, in your own words, when a company would record a contingent liability (i.e. a contingent loss) on its books. List some types of contingent liabilities. Do companies ever record contingent assets (i.e. contingent gains)?"

A contingent liability is an estimate of a future liability the company may incur if certain events occur. In order to be placed on the balance sheet, the contingent liability must be probable and estimable. Companies may also disclose contingent liabilities in the footnotes of their financial statements if they don't have a reasonable estimate or likelihood of occurrence. A company could record contingent liabilities for pending lawsuits, in which, they are more than likely going to incur costs and they have a reasonable estimate of how much those costs will amount to. Businesses are not allowed to record contingent assets, even if the acquisition of the asset is probable.

Possible Contingent Liabilities:

1. Pending lawsuit
2. Product Warranty
3. Product claims from customers
4. Guarantees of obligations to others (i.e. bank/lender)
5. Agreements to repurchase product that has been sold

8.3 Question B

Question: "Product warranties are a common contingent liability. Consider a piece of equipment such as a telescopic joint, which BP purchases from GE Oil and Gas. The telescopic joint compensates for heave and offset on drilling vessels and is sold with a two-year warranty against defects. From BP's perspective as the purchaser of the telescopic joint, what is a product warranty? From the perspective of GE Oil and Gas, the manufacturer of the telescopic joint, what is a warranty?"

BP:

From BP's perspective a product warranty on the telescopic joint is an agreement with GE Oil and Gas that would state terms of return or repair on the joint. If BP were to find a defect in the joint, they would have the ability to either request GE Oil and Gas to repair it, or they would be able to return it for a refund or new joint.

GE Oil and Gas:

From GE Oil and Gas' perspective, a product warranty on the telescopic joint would be a contingent liability on their financial statement. They are willingly agreeing to either offer a refund or incur costs to repair their telescopic joint if there are any manufacturing defects.

8.4 Question C

Question: "What judgments does management need to make to account for contingent liabilities in general and accrued warranty costs in particular? How does a claim for damages resulting from the Deepwater Horizon oil spill differ from a warranty claim on a piece of equipment such as a telescopic joint?"

A company must first look at their costs per individual product, then they must make a reasonable estimate on the amount of product that will be returned under their warranty. They would debit an expense account at the beginning of the year and credit an accrued warranty liability account. At the end of the year they would need to make an adjusting entry to account for the actual expenses incurred due to the warranty. The claim for damages in the oil spill would differ from traditional warranty claims because the damage went far beyond the cost of the product. GE Oil and Gas most likely did not have an accrued warranty and liability account balance high enough to pay for something as expensive as an oil spill. Thus, GE Oil and Gas had no contingent liability on their books for something as catastrophic as the oil spill.

8.5 Question D

Question: "Describe some of the estimates that BP must make to account for the contingencies associated with the Deepwater Horizon oil spill. By way of comparison, the Exxon Valdez oil spill took place on March 24, 1989. Litigations continues as of early 2011."

BP must make estimates for not only product losses due to the oil spill, but they also must look at all the legal implications and industries that will come seeking reparations for the damage caused by the spill.

List of Industries/People Impacted:

- Individuals
  - Those who live along the coast-line could have medical expenses related to the exposure to raw oil. They could also seek reparations for property damage due to the oil. These complaints would be reasonable in my mind; however, insurance would probably cover most of the losses. This would in turn cause the insurance companies to seek repayment from BP.
- Fishing Industry
  - Fishermen wouldn't be able to operate due to the oil, basically shutting down business in the gulf. The fish in their nets may not be safe to eat for years to come following the oil spill, so the damage goes far beyond the current period of the oil spill. If fishermen were to sue BP,

I would agree that it is reasonable for them to do so. Their livelihoods were lost due to the oil spill that BP directly caused. The loss of yearly profits would be estimable, and they can predict how much they would have made in years to come.

- Tourism
    - Whether it be tourist attractions such as offshore fishing, cruises, or resorts along the coast. People were far less likely to travel to these areas due to the oil spill, and lack of clean beachfront. This caused the tourism industry to take a nose dive, especially because tourism and fishing are two of the main sources of income for the gulf coast. The tourism industry has the right to reasonably sue, by using their previous years of profit they would be able to estimate their future profits and adjust it due to their losses from the oil spill.
- Seafood/Dining
    - Many restaurants all around the country were forced to either stop selling seafood from the gulf or change their distributors to buy seafood from other areas of the world. This could have increased their cost and/or decreased their business. In this situation, I don't think it would be reasonable for a restaurant to sue BP oil, because they have access to other distributors/regions to get seafood from.
- Wildlife
    - Many animals such as birds, fish, whales, and sea otters were affected by the oil spill. Whales, sea otters, and birds were found suffocating

> offshore because their nostrils would become filled with oil from the surface. Fish swam through the oil spill either causing them to suffocate or gain health defects. Blue Fin Tuna were one of the major species of fish that were in birthing season at the time. At the moment, the fish that were babies at the time haven't reached adulthood, so we don't know the true effects on them yet. Luckily for BP, animals can't sue so they don't have to worry about reparations. However, many societies and groups around the world may have reasonable amounts to seek from BP for loss of life among the wildlife, as long as they can find a reasonable way of estimating the worth of an animal's life.

BP would have to account for all these industries and reasonably estimate their losses from each. Lawyers would have to give BP estimates on losses from lawsuits, and the government also fined them $18 billion for their actions. Along with the lawsuits and penalties, BP lost a lot of money due to the clean-up efforts. It took nearly $4 billion in clean-up expenses, along with another $4-5 billion in penalties. From an auditor standpoint, you'd have to look at all the contingent lawsuits and validate if they are reasonable estimates and if they are likely to lose the case. This would be difficult, mainly because the effects of the spill will be felt for many years to come in the Gulf so the estimates may change throughout the years. Auditors would also need to draw a boundary around these losses, because BP can't write everything off as a contingent liability. They would either have to pay for all the losses in the current period or declare bankruptcy. All of this information snow-balled into a massive effect on the accrual of loss liability. On any normal year, BP would have a fairly substantial loss liability just due to the business they are in, however, in the years following the oil spill their loss liability would need to be increased dramatically since

CASE 9: The Wendy's Company

An Analysis of Equity Method Investments

Prepared By: Grant Rudow

April 3rd, 2019

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9.1 Case Introduction

In this case, we studied the joint-venture between The Wendy's Company and Tim Horton. I studied the positives of companies entering into a joint venture, over a complete takeover and how it can help both companies in many ways. I also learned about the equity method of investments. The equity method allows for a company to buy a percentage of stocks from a company and gain influence over said company. Through the equity method, a company doesn't have to buy 50% ownership to be able to influence business decisions, they only need at-least 20%. I then analyzed Wendy's financial statements and pulled out details on the impacts of the joint-venture on their balance sheet, statement of operations, and statement of cash flows. I frequently referenced Note 8, in the financial statements which gave further details into their investment activity throughout the years. In conclusion, I think this case was very helpful in learning more about the equity method of investing and seeing it in a real-world setting.

9.2 Question A

Question: “In general, why do companies enter into joint-venture agreements?”

Companies tend to enter into joint-venture agreements, when both companies have a similar business goal in mind and are targeting the same market. The two companies can pool together their resources, and both share in the profits. Companies can harness each other’s human capital, technology, and industry knowledge to capitalize on their marketplace. Joint-ventures are also ideal for companies looking to spread their risk. By bringing in a second party, a company can offload some of their business risk, and distribute it to their joint-venture partner. This way, the risk of a project failing has less of an impact on a business decision, since the costs of the project are being split between the two companies. Often, joint-ventures are also used for companies to expand into new foreign markets. By joining with a company that already has a distribution line through a foreign market, a company can quickly and cost-effectively gain a new consumer base in a new country.

9.3 Question B

Question: "Consistent with U.S. GAAP, Wendy's uses the equity method to account for its joint venture in TimWen. Briefly explain this accounting method. In your answer, be sure to comment on how the investing company accounts for its initial investment and any subsequent income and dividend activity of its investee."

Equity method investing occurs when a company, such as Wendy's, purchases at-least 20% of another company's stock (i.e. Tim Horton). Since the purchasing company owns a minimum of 20% of the stock, they are able to exert some force on the purchased company's business decisions. More than likely the parent company would have at-least one corporate executive sit on the board of the purchased company, in turn, giving the parent company more influence over the decisions. Due to the 20% ownership, the parent company is also entitled to a percentage of the income from the purchased company. The more ownership the parent company retains in the purchased company, the larger the portion of income they may recognize. When entering a joint-venture by the equity method, the parent company records the investment at cost, and the cost is adjusted afterwards depending on the income and dividends received from the purchased company.

9.4 Question C

Question: "When a company purchases shares (ownership) in another company, the investment amount may exceed their share of the book value of the underlying net assets of the investee. How does the investing company account for this excess amount under the equity method?"

Excess on purchase price is normally allocated to goodwill, however, in this case the excess on the purchase price will be allocated to the investee's assets and liabilities. The excess on purchase price will be split among the acquisition accounting premium (AAP). The AAP is separated into 2 sections, the first being the write-up of identifiable assets and liabilities to fair value, and the second being goodwill. In the case of Wendy's, they are going to allocate their excess purchase price into the first section of AAP, which means they are writing up the identifiable assets and liabilities to fair value. This will allow for an annual charge that the parent company (Wendy's) will make to record the systematic depreciation and amortization on the written-up charge. If it had been allocated to the goodwill section, it would need to be tested annually for impairment, because in the U.S. we don't amortize the goodwill portion of AAP.

9.5 Question D

Question: "Consider the information in Note 8. What amount did Wendy's include on its 2012 and 2011 balance sheets for their equity method investments? Where does this appear on Wendy's consolidated balance sheet?"

Wendy's shows a balance of $89,370 in 2012, and a balance of $91,742 in 2011. This amount is shown in the Investments section of the consolidated balance sheet.

9.6 Question E

Question: "Using information in Note 8, compare the amount recorded for Wendy's investment in TimWen at December 30, 2012 with Wendy's 50% share of TimWen's equity at December 30, 2012. What accounts for the difference between these two amounts?"

On December 30, 2012 Wendy's has the investment recorded as balance in "partner's equity" at $70,565. With Wendy's 50% share in TimWen's equity their balance on December 30, 2012 would be $35,283[a]. The difference between these two balances is $54,088, which is known as the acquisition accounting premium. The AAP will include goodwill and the write-up of identifiable assets and liabilities to fair value.

[a] (70,565 x 50%) = 35,283

9.7 Question F

Question: "Consider the information disclosed in Note 8 regarding Wendy's investment in the TimWen Joint Venture."

i. How did Wendy's equity method investment in TimWen affect their earnings before taxes in 2012 and 2011? Where does this appear in Wendy's consolidated statements of operations?

Wendy's earnings before taxes in 2011 was \$10,571[b] and their earnings before taxes in 2012 was \$10,551[c]. The earnings are adjusted to the amortization of the original acquisition and they are placed in the "other operating expenses" section of the consolidated statement of operations.

[b] \$13,505 – 2,934 = \$10,571

[c] \$13,680 – 3,129 = \$10,551

ii. Prepare the journal entry to record Wendy's share of TimWen's 2012 earnings.

Dr. Equity Investment	13,680	
Cr. Equity Income		13,680

iii. What is the amount of the amortization of the purchase price adjustment in 2012? Prepare the journal entry to record the amortization of the purchase price adjustments 2012.

The amount of amortization is equivalent to the amount of the write-up of identifiable assets and liabilities, which is $3,129 in 2012.The amortization amount is based on an average 21-year life.

Dr. Loss on Investment	3,129	
Cr. Equity Investment		3,129

iv. What amount of dividends did Wendy's receive from the TimWen joint venture in 2012 and 2011? Prepare the journal entry to record the receipt of dividends from TimWen for 2012.

Wendy's received dividends amounting to $15,274 in 2012 and $14,942 in 2011.

Dr. Cash	15,274
Cr. Equity Investments	15,274

9.8 Question G

Question: "Consider the information in the statement of cash flows."

i. The operating activities section of the statement of cash flows reports a negative adjustment for "Equity in earnings in joint ventures, net" of $8,724 in 2012. Reconcile this amount to the information disclosed in Note 8. Explain why a negative adjustment is made to arrive at net cash operating activities."

In 2012, Wendy's only received dividends, which would have been subtracted out of equity income. Since it is a non-cash activity it does not get reported on the income statement. Combining the $-1,827 from their Japan venture and the $10,551 from TimWen, we reach the balance of $8,724 for "equity in earnings in joint ventures, net."

ii. The operating section also reports a positive adjustment for "Distributions received from joint venture" of $15,274 in 2012. Reconcile this amount to the information disclosed in Note 8. Explain why a positive adjustment is made to arrive at net cash from operating activities.

A positive adjustment is made to account for receiving of dividends, which were not originally included on the income statement. The adjustment would be the same as the "distributions received from joint venture" balance of $15,274.

CASE 10: Johnson & Johnson

An Analysis of Retirement Obligations

Prepared By: Grant Rudow

April 12th, 2019

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10.1 Case Introduction

In this case, we studied the effect of retirement plans on a company's financial statements. More specifically, we analyzed Johnson & Johnson and their defined benefit plan. Through this case I was able to learn more about pensions, pension obligations and how companies record them on their books. I learned about the flow of funds when a company invests with a pension fund and what happens to those funds as they move through their life-cycle, until they reach the employee. I also gained an understanding of the journal entries related to pension obligations on the liabilities side and plan assets. I found the actuarial estimations to be interesting, and how the company had to account for differences between the estimation and actual returns on investments. This case was very useful because it not only gave me a better understanding of retirement plans, but I was also able to learn the effects it has on a company and their financial reporting.

10.2 Question A

Question: "There are two general types of retirement (i.e. pension) plans – defined benefit plans and defined contribution plans."

i. How do these two types of plans differ? Which type does Johnson & Johnson have?

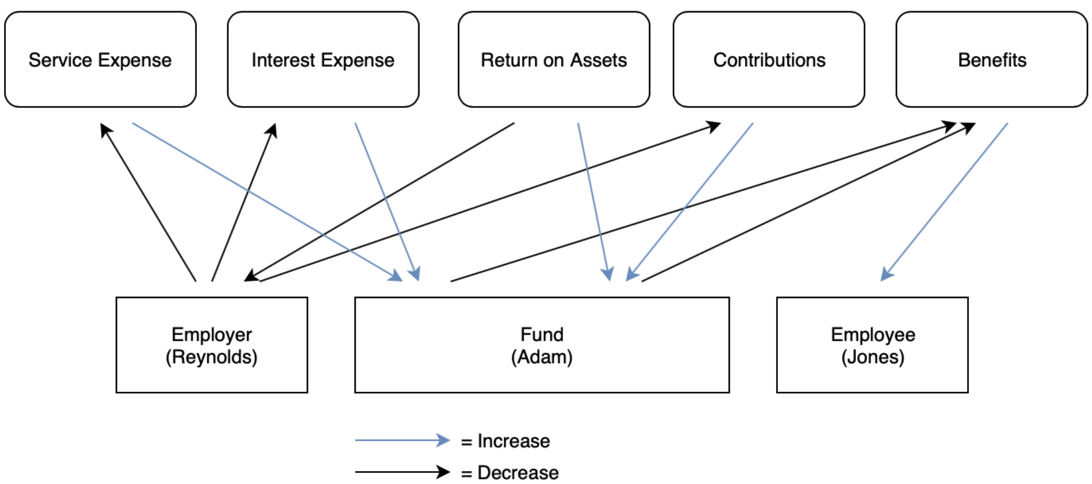
A defined benefit plan provides employees with a specified payment at the time of their retirement. The specified payment is based on the employee's salary, years of service, level of service, etc. A defined contribution plan gives employees and employers the opportunity to contribute funds to the plan over time, in turn, saving for their retirement. In a contribution plan, the employee decides how much is invested into the fund and the employer matches those contributions, to a certain amount. Johnson & Johnson operates with a defined benefit plan.

ii. Explain why retirement obligations are liabilities.

Retirement obligations are stated on the balance sheet as liabilities, because they are considered the present value of funds to cover their future pension expenses. Companies must keep track of the amount needed to pay in the future to their employees, thus they record retirement obligations as liabilities.

iii. List some of the assumptions that are necessary in order to account for retirement plan obligations.

1. Remaining service life of employees
2. Salary raises of employees
3. Promotions of employees
4. Mortality rates of employees



10.3 Question B

Question: "In general, companies' pension obligations are influenced each year by four main types of activities: service cost, interest cost, actuarial gains or losses, and benefits paid to retirees. Explain each of the four activities in your own words."

Service Cost: A service cost is the additional liability a company must set aside for every period an employee works. The service cost is used to estimate the amount needed to contribute to the employee's pension plan.

Interest Cost: An interest cost is the additional liability a company creates for every additional year an employee works while approaching retirement. The interest cost is different from the service cost, because it is calculating the additional interest the fund will earn, at present value.

Actuarial G/L: Actuarial gains and losses are defined by the difference between the actual pension payments, from the employer to the employee, and the expected pension payment. A loss occurs if the company pays a higher amount than expected, and a gain occurs if the company pays a lower amount than expected.

Benefits Paid to Retirees: Benefits paid to retiree's are the payments an employer makes to their employee upon their retirement.

10.4 Question C

Question: "In general, companies' pension assets are influenced each year by three main types of activities: actual return on pension investments, company contributions to the plan, and benefits paid to retirees. Explain each of the three items in your own words."

Actual Return on Pension Investments: The actual return on pension investments is defined by the dividends, interest, and capital gains generated by the assets held by a pension fund, such as Fidelity. These returns would increase the company's pension assets.

Company Contributions to the Plan: Company contributions to the plan are the cash payment a company makes to the pension fund. These payments would increase the company's pension assets.

Benefits Paid to Retirees: These are the payments a company makes to former employees out of their retirement plan agreement. These payments would decrease the plan assets.

10.5 Question D

Question: “In general, companies’ pension expense and pension plan assets both have a “return on plan assets” component. How do the two returns differ? Explain the rationale for this difference.”

The return on plan assets relating to pension expense is most commonly the expected return that is estimated by an actuary. These expected returns reduce the pension expense in the current period. On the other hand, the return on plan assets in relation to pension plan assets are the actual returns the company receives from the fund’s investments. These returns could be either a gain or loss, depending on, if the return was higher or lower than the expected return stated by the actuary.

10.6 Question E

Question: "Johnson & Johnson provides other benefits to retirees including health-care and insurance benefits. What is the primary difference between the company's other-benefits plan and its retirement plans?"

The primary difference, as stated on page 60, between Johnson & Johnson's other-benefits plan and its retirement plans is that the company doesn't fund the health care and insurance benefits in advance of an employee's retirement. In other words, Johnson & Johnson doesn't invest any money in the other-benefits plans. Rather, they incur expenses on them after the employees are retired.

10.7 Question F

Question: "Consider Johnson & Johnson's pension expense detailed on page 61 of the company's annual report. Note that the company uses the term "net periodic benefit cost" to refer to pension expense."

i. How much pension expense did Johnson & Johnson report on its 2007 income statement?

Johnson & Johnson reported $1,253 million in 2007, which is found by combing both the service cost of $597 million and the interest cost of $656 million.

ii. Prepare the journal entry to record the service cost and interest cost portion of the 2007 pension expense.

Dr. Pension Expense	597,000,000	
Cr. Pension Benefits Obligation (PBO)		597,000,000
Dr. Pension Expense	656,000,000	
Cr. Pension Benefits Obligation (PBO)		656,000,000

10.8 Question G

Question: "Consider Johnson & Johnson's retirement obligation, that is, the pension liability, as detailed on page 62 of the company's annual report."

iii. What is the value at December 31, 2007, of the company's retirement plan obligation? What does this value represent? How reliable is this number?

The projected benefit obligation at the end of the period is valued at $12,002 million. This value represents the company's present value of pension expense to be paid in the future. This number is based on an actuarial estimation, so it is reliable, but not always 100 percent accurate.

iv. What is the pension-related interest cost for the year? Compute the average interest rate the company must have used to calculate interest cost during 2007. Does this rate seem reasonable? Explain.

The pension-related interest costs for 2007 were $656 million, which is based on an interest rate of 5.63 percent. This rate seems reasonable because they used a similar rate of 5.6 percent in 2006.

v. What amount of pension benefits were paid to retirees during the year? Did Johnson & Johnson pay cash for these benefits? How do the benefits paid affect the retirement plan obligation and the retirement plan assets?

Johnson & Johnson paid $481 million in 2007 to retirees. They paid cash for these benefits, decreasing the balance of the pension benefits obligation and the retirement plan assets.

10.9 Question H

Question: "Consider Johnson & Johnson' retirement plan asset that is, the pension plan asset, as detailed on page 62 of the company's annual report."

i. What is the value at December 31, 2007, of the retirement plan assets held by Johnson & Johnson's retirement plan? What "value" is this?

At December 31, 2007 Johnson & Johnson shows their plan assets with a value of $10,469 million. This amount is an estimate of the company's plan assets at fair market value.

ii. Compare the amount of the expected return on plan assets to the amount of the actual return during 2006 and 2007. Are these differences significant? In your opinion, which return better reflects the economics of the company's pension expense?

The expected returns for 2006 and 2007 are $701 million and $809 million, respectively. In 2006, the actual return was $966 million, which is higher than the expected. Contrasting that increase, 2007 shows an actual return of $743 million which is below their expected return. The difference was significant in 2006, which could have led the company to adjust their expected return in 2007, in turn, causing an insignificant difference. This shows that the expected return is the better reflection of the economics of the company's pension expense.

iii. How much did Johnson & Johnson and their employees contribute to the retirement plan during 2007? How does that compare to contributions in 2006? (See page 63)

Johnson & Johnson, along with their employees, contributed $379 million in 2007 and $306 million in 2006. Showing that the contributions increased from 2006 to 2007.

iv. What types of investments are in Johnson & Johnson's retirement plan assets?

Johnson & Johnson's retirement plan assets contain investments in both equity securities (79%) and debt securities (21%) in 2007.

10.10 Question I

Question: “Is the company’s retirement plan under funded or over funded at December 31, 2007? At December 31, 2006? Where does this funded status appear on the company’s balance sheet?”

In 2007, it appears that the retirement plan is underfunded, because there is a net actuarial loss of $1,027 million. The year 2006 also contains a net actuarial loss of $1,996 million. This amount appears within the accumulated other comprehensive income section of the company’s balance sheet.

CASE 11: CEASA: Balance Sheet-Based Model

An Analysis of the Balance Sheet-Based Model of Financial Reporting

Prepared By: Grant Rudow

April 23rd, 2019

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11.1 Case Introduction

In this case, we read an article written by the Center for Excellence in Accounting and Security Analysis that analyzed the balance sheet-based model of financial reporting. The article offered four main points contradicting the current direction the FASB and IASB are headed in relation to the income statement approach vs. balance sheet approach. After reading the article I feel I have a much deeper understanding of the both methods, and the history behind the integration of the FASB and IASB. Prior to reading this article, I didn't know much about the integration between the two bodies and I especially didn't know about the standards they were looking to get rid of. I can't imagine how much effort needs to go in to creating a whole set of standards that will govern the entire world in relation to accounting. It is obviously a very detailed and thought out process, and I'm sure they appreciate articles, such as this one, that play a devil's advocate to their projected thoughts. At the end of the day, we're all humans and we can't think of every possible situation. So, I'm sure it is nice to have input from others of the positives and negatives of their ideas before they are fully implemented. At first the size of the article was a little daunting, but after I began reading it, I found it to be a very intriguing topic. Typically, we don't read about what the FASB is doing wrong, so it was refreshing to hear an outside viewpoint on the ideas FASB has produced over the years relating to earnings and revenue recognition.

11.2 Question A

Question: “Read and thoroughly summarize the article”

The article, “On the Balance Sheet-Based Model of Financial Reporting” is written to further the readers understanding of the efforts being put into place to join the Financial Accounting Standards Board (FASB) conceptual framework and the International Accounting Standards Board (IASB). More specifically, it is written to analyze the balance sheet approach of financial reporting and compare it to the income statement approach. The article begins with an analysis of the history behind both the FASB and the IASB, and what led them to pursuing the balance sheet method as the generally accepted method of financial reporting. The principal differences between the two methods lies in the importance of earnings recognition. The income statement approach is based heavily around the determination of revenues, expenses, and earnings. While the balance sheet approach focuses on assets and liabilities. Up until the creation of the FASB in 1973, the income statement approach dominated accounting theory, because the correct determination of earnings was considered to be the primary goal for all financial reporting. With the development of the FASB, the accounting world saw a change, with a heavier emphasis on the balance sheet method. In the mid-1970’s, the Board concluded that the balance sheet approach was “the only logical and conceptually sound basis of accounting,” which led to this approach becoming the “corner-stone of standard-setting and financial accounting in general.” Due to this change, the FASB has also begun working on new standards for fair value valuations of assets and liabilities. The FASB released many new standards relating to fair value since the late 1990’s, and they continue to look into ways of securing the fair value concepts among assets and liabilities.

The article then goes on to describe the integration of the fair value approach throughout the entire world. At the time, the International Accounting Standards Committee (IASC) adopted the balance sheet approach and based their accounting standards heavily on the FASB framework. The IASB replaced the IASC and continued to model their standards based on the FASB framework. In recent years, the IASB and the FASB have been working towards a joint commitment, which would create one set of accounting standards that would be upheld worldwide. The two Boards have been forced to compromise on many things throughout the journey to integration, and they both agree that the balance sheet is the appropriate method to use.

In 2006, the FASB released the Preliminary Views which added details of the current integration with the IASB and their outline on how they hope to achieve a world-wide standard. The Preliminary Views state that the FASB and IASB are looking to create a more concrete conceptual framework and are phasing out terms such as “revenues”, “expenses”, “earnings”, and “income”.

After detailing the history of the balance sheet approach and the income statement approach, the article moves into its four main critical points surrounding the balance sheet approach. The first of the four points has to do with the way companies operate. In short, companies use assets to earn revenues, through continuous shuffling of assets on and off their balance sheet. The article points out that this is one of the weaknesses of the balance sheet method, since most companies do not store assets and grow them, it’s hard to realize revenues based on the growth of the assets. The majority of assets on a company’s balance sheet are temporary and serve a specific purpose for a limited time. Another crucial point from a company’s view is the process of making budgets for future periods. Typically, managers will forecast desired revenues first and make a budgeted income statement to support. After making a budget a manager will then look at the assets required to meet desired revenues. Yet another reason as to why the income statement approach is a preferred method among companies. The article also reminds the reader that the FASB is most concerned with investors, since they are considered the primary user of financial statements. These investors primarily base their decisions on a company's income statement, not their balance sheet. A company is valued based on projected revenues and projected costs before an analyst considers the balance sheet and statement of cash flows. The article concludes their first point by reminding the reader that income statement operations relate to operating, while balance sheet-oriented operations relate to financing activities. With that being said, firms and investors are primarily focused on operating revenues and costs, making the income statement approach a better fit.

The second point the article analyzes is the circulatory wording the FASB uses when defining assets and how they relate to earnings. The entire balance sheet is oriented around assets, because the FASB believes that assets are the fundamental foundation of accounting. They argue that "one cannot define a change in value before establishing what value is, and that leads to asset and balance sheet-based accounting." However, the article delves deeper into the definition of an asset, stating that the FASB argues that an asset is defined in terms of expected earnings, which contradicts the idea that assets are more important than earnings. The article concludes this topic by reminding the reader that assets are much harder to conceptually understand and difficult to relate to operations, in comparison to income. Yet another reason supporting that the income statement approach is a better method.

The third point analyzes the breakdown on usefulness of earnings if the balance sheet approach were made the standard. Investors require a "highly persistent and predictive" form of future earnings, which the income statement approach provides.

Contrary to this, the balance sheet defines earnings as “changes in assets,” which creates a low predictability and persistence of earnings. The article terms balance sheet earnings as “useless earnings” and further states that they could lead to a deterioration of the entire accounting profession.

The final point the article states covers the remaining problems that hadn’t been discussed up until that point. One of the primary points in this section is an analysis of the market valuation of assets on the balance sheet. This relationship between the market and the values on a balance sheet could lead to issues if the market were to deviate from the fundamental accounting procedures. This point is concluded with the statement that the FASB must recognize the difference between the “real economy” and the “financial markets world.”

The article concludes with a few possible solutions to the problems that were discussed above. The main takeaways from this section pertain to a renewed emphasis on the expense matching principle and revenue recognition. Also, a need for a deeper analysis of operating and financing activities on the balance sheet, with an emphasis on a clear distinction between the two. At the time, the FASB and the IASB are not entirely focused on the matching principle, which the article believes to be one of the more important concepts in today’s accounting. In conclusion, the article was written not to create an argument, but to offer a devil’s advocate to the FASB and the IASB’s current thought process.

11.3 Question B

Question: "How did reading this article change your current way of thinking?"

Prior to reading this article I knew a little bit about the income statement approach and the balance sheet approach; however, I had never delved as deep as I did while reading this article. We briefly cover the integration of the FASB and the IASB in our accounting classes, yet we never really learned what steps are being taken to integrate the two. I found it very interesting to see the actual thoughts on the integration, in which they had presented to the world. The points that were brought up gave me a new mindset on what earnings truly stand for and their importance in the accounting world. The article referenced how companies operate in relation to earnings, which was something I had never thought of before. The process for budgeting relies heavily on projected earnings and considers asset values to be a supporting factor at the end of the budgeting process. I agree with the article that earnings are much more important to a company's operating platform, since it is what the company bases most of their decisions on.

Another topic in the article that I found to be very interesting was the analysis of the foundations of accounting, and how the income statement approach supports the core elements. The article opened my eyes to some of the shakier definitions given by the FASB. Specifically, their definition of an asset, that relies heavily on the idea of earnings. Which contradicts their decisions to stray away from the term "earnings." I think it is important that the FASB consider their core definitions, before they decide to cut away certain approaches, especially one as significant as the income statement approach. One of the primary takeaways I had from this section of the article, was that the FASB isn't as completely put together as we see in textbooks. There are many standards and definitions that are not fully ironed out. They seem to have been thrown together in a rush to get them out to the public and are edited as problems arise. I believe, that in order for the FASB and the IASB to fully integrate and release a set of standards world-wide, they must first create a concrete, ironed out set of core conceptual concepts. The article highlighted this thought, and I agree that it is the most important part to the whole process. Without a strong base to create a foundation for all the standards being set there are openings for loopholes and poorly formed rules that could be ambiguous and lead to trouble further on down the line. In conclusion, I think this case was very helpful and it's taught me to keep an eye on the FASB and the process of integration with the IASB. In a few short years, everything that FASB does will likely have a large impact on my career, so it would be better to stay up to date with news coming from the Board, so I'm not blindsided. Although, I know that no matter how hard I try to stay up to date I may still be caught off guard. If that does happen, at least I will have an understanding of the rules and definitions and know where the changes stem from.

11.4 Question C

Question: "How will you use this information in your future career?"

I think this information will be very useful in my future career. As I enter the Capital Markets & Accounting Advisory world, it will be very important for me to have a deep understanding of financial statements. More specifically, I will need to be able to analyze a company's statements and investigate their earnings in order to properly advise a client. This specifically relates to the point in the article that references companies being valued based on their earnings, not the value of their assets. After learning from this article about the possible changes that could come to the forefront in the future, I will be better prepared to tackle issues relating to the value of a company. I know now that the balance sheet approach analyzes earnings in relation to the derived benefit of an asset. While on the other hand, the income statement approach shows earnings based on the revenues derived from the assets the company holds.

If the FASB does decide to completely remove the income statement approach, it will most likely make my job much more difficult. Since assets are much hard to place a value on in comparison to company earnings. The value of assets and the company will be based heavily on the market. If there are unforeseen market changes, it could greatly affect the company's earnings. In today's market, the company is still valued based on the market, but the market determines the value of a company based on their current and projected earnings. If companies are unable to report current and projected earnings, we could see problems that arise within the market itself. Financial analysts and investors will have a much harder time deciding on the value of a company and, whether or not, it is worth investing in.

CASE 12: Google Inc.

An Analysis of Earnings Announcement and the Information Environment

Prepared By: Grant Rudow

April 28th, 2019

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12.1 Case Introduction

In this case, we studied the effects that earnings performance has on a company's stock price. We also analyzed the difference between GAAP and non-GAAP performance measures. More specifically, we got excerpts from Google's financial statements which gave an inside look at the difference between their GAAP and non-GAAP reporting, in relation to their net income. We saw that Google chose to exclude certain expenses in order to report a non-GAAP net income that was substantially higher than their GAAP income. Furthermore, we looked at the history of Google's stock price and the correlation between the price and the announcement of their quarterly earnings. It was evident that the earnings announcements do have an impact on the stock price, and that concept was proved to be true after reading the Wall Street Journal article that was attached to the case. Investors rely on the earnings reports to make their decisions on what to do with their investments in the stock market. In Google's Q4 earnings, investors saw Google make the decision to sell Motorola, which had been dragging down company earnings, and produce actual revenue numbers that exceeded the analyst's forecasts. I believe this case was very helpful, because it helped connect our accounting world to the outside world. Normally you don't see the direct correlation of financial statements to the stock market, but in this case, we were able to see how a company's non-GAAP performance measures can have a direct impact on their stock price and the public's opinion on the company's profitability.

12.2 Question H

Question: “Read the excerpts of the press release titled “Google Announces Fourth Quarter and Fiscal Year 2013 Results” and review Google’s operating performance reported in the statements of income accompanying the press release.”

ii. The press release includes information about non-GAAP financial measures for the fourth quarter of 2013. Consider the table that reconciles GAAP measures to the non-GAAP measures. What explains the difference between GAAP net income and the non-GAAP equivalent? Do you agree with each of Google’s adjustments in computing non-GAAP earnings? Why or why not?

The difference between GAAP net income and non-GAAP net income occurs due to certain exclusions of expenses. The non-GAAP net income excludes stock-based compensation expense (SBC), restructuring and related charges, income tax effects due to the SBC and restructuring eliminations, and net loss from discontinued operations. I agree with Googles elimination of restructuring costs; however, I disagree with their exclusion of SBC expenses. They state in the press release that the SBC expenses are recurring for the foreseeable future, so I don’t see why they would need to exclude such a large cost from their net income, other than to make it look better. The SBC expense isn’t a one-off cost or a cost that is hard to predict, so in my opinion it shouldn’t be excluded.

12.3 Question I

Question: "Use the attached stock-market charts for Google for the period January 1, 2013, through February 14, 2014, to answer the following questions."

i. Compare Google's fiscal 2013 earnings performance with the movement in Google's stock price over 2013.

Google's fiscal 2013 earnings performance in Q1 prompted an uptick in their stock price. When Q2 was announced there was a relatively small decline in price followed by a sharp increase occurring right before the Q3 announcement. According to the chart, it seems like something caused a sharp uptick in mid-October, then when the earnings were announced the increase leveled out and began increasing at a steady rate through the Q4 earnings announcement.

ii. Compare Google's 2013 stock price performance with the performance of the broader set of firms trading on the NASDAQ exchange.

Comparing Google's 2013 performance to the NASDAQ exchange there isn't much deviation from the rates of other firms. Google is above NASDAQ for the majority of the year, and they differed from the NASDAQ rate around their Q3 earnings announcement. The sharp jump in price in mid-October is the only drastic difference from the rest of the NASDAQ exchange.

iii. Based on the stock market chart, did the market perceive the earnings news in Google's press release dated January 30, 2014, as "good news" or "bad news"? (The press release was made available after the close of trading for the day)

Based on the stock market chart, it seems that the market perceived Google's press release was good news. I came to this conclusion because after the Q4 earnings announcement there is a spike on the chart, showing an increase in price. The increase in price is due to investors believing that the stock is worth more, and this is commonly due to earnings statements that affirm their beliefs in the profitability of the company.

12.4 Question J

Question: “Read the *Wall Street Journal* from January 30, 2014 titled “Google Reports Higher Profit.”

i. According to the article, how did Google’s fourth quarter revenue and earnings compare to the consensus analyst forecasts at the time of the earnings press release? Are these relations consistent with the positive stock market reaction following the press release?

Google’s fourth quarter revenues and earnings exceeded investors’ expectations. The analyst predictions were right around the actual numbers provided by Google, but Google showed higher actual revenue and earnings compared to the forecasts. These relations are consistent with the stock market reaction, because the earnings numbers were a good sign to investors.

ii. What other factors does the article discuss that might contribute to the market’s positive reaction to the earnings press release? Are there any factors that might cause investors to be concerned about Google’s recent performance?

One of the key factors the article discusses was the sale of Motorola to Lenovo. According to the article, Motorola had been weighing down on Google’s bottom-line and Google had been forced to absorb $2 billion in losses since acquiring Motorola the year prior. At the same time, investors have reason to be concerned about the decline in the average amount Google receives for each click. As society has moved away from desktop computers and more toward mobile phone usage, Google has shown a decrease in revenues per click. However, further in the article Google offers alternatives ways to generate revenue through a more smartphone-oriented approach. These new methods are still being implemented so it may be a little while before investors see the benefit of the new methods.