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A CASE BY CASE STUDY OF ACCOUNTING FUNDAMENTALS

by
Shane Ferrero

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

Oxford
May 2020

Approved by

Advisor: Victoria Dickinson

Dean: W. Mark Wilder

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ABSTRACT

SHANE FERRERO: A Case by Case Study of Accounting Fundamentals

(Under the direction of Victoria Dickinson)

Accountancy attempts to capture and record business activities with a treatment as reflective of economic realities as possible. The dynamic nature of the business world results in accounting standards being an evolving set of rules with various considerations necessary. The case studies examined for the purpose of this thesis looked into many of these considerations to exemplify how the field of accounting manages to recognize and manage complicated business transactions. For the purposes of gathering cases, case studies were sourced from academia from the University of Mississippi as well as other institutions. The dissection of the case studies provided a deeper and broader insight into how accountants work to develop coherent and representative solutions in accounting for particularly complex business issues, such as the recording of liabilities pending litigation after an oil spill or the valuation of goodwill for company brands. Ultimately, the conclusions reached highlight the challenging but necessary processes that inform accounting standards.

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Data Analytics: Splunk

Shane Ferrero

Accy 420

Dr. Dickinson

5 September 2018

Executive Summary

For the purposes of our data analytics research, I explored the capabilities of business software Splunk. The research I conducted allowed me to better understand the role that data management software plays in the task of accounting in the era of big data. As the availability of data continues to grow, the effective organization and utilization of data for the production of meaningful information will prove to be critical in the success of one business over its competitors; this trend will likely develop further as I enter the industry. A software program such as Splunk underlines the importance of blocking out the static noise and mining the insights that are most important for effective operation in the modern marketplace. The completion of this case included not just research of the software's capabilities, but also a discovery of and proposition of applications in areas like auditing and tax planning, as well as a persuasive presentation of how an investment in a tool like Splunk can benefit a company's staffing and operations, and consequently, its profitability. Ultimately, the understanding that arose from our examination into business information software equips us with valuable insights into the digital nature of today's business environment and what it looks like to be an effective accountant, utilizing modern tools for the better operations of a firm.

1. **Identify the purpose of this tool and describe, in general, how it is used to make business decisions.**

Splunk's key purpose rests in its ability to aggregate a variety of data involved in a company's operations and provide accessible presentations of indexed data so that useful information can be easily extrapolated. Working across platforms, Splunk's data collection abilities are wide in range, and the software is capable of pulling data points in a large variety of contexts. As examples, Splunk can measure revenues across multiple streams, such as online (including mobile) sales and physical retail sales, but it can also be used to monitor physical assets of the company as well; for instance, Splunk can be used for oversight of server health, meaning that Splunk not only monitors the real-time performance of transactions taking place on a server, but it can track the integrity and health metrics of the server itself and predict degradation before any catastrophic loss takes place. Splunk is also highly effective in a company's security operations. Its ability to monitor physical and digital entries means that a company can aggregate data such as key swipes into a physical facility and online web logins simultaneously to provide an overarching view of the company's security positioning. Regardless of how a business's operations are modeled, Splunk is capable of increasing value – it's nature as a horizontal software allows it to be relevant broadly across industries.

A large portion of the software's value is derived from its ease of use, even for those untrained in management information systems; its Web-style interface allows for employees in a variety of roles to easily determine what metrics are most pertinent to their tasks and how available data should be interpreted to increase clarity. Because Splunk is developed to incorporate data from a variety of sources, it can carefully

accumulate often overlooked data and portray a bigger picture, incorporating all of a company's interactions for greater vision. As Splunk examines critical metrics such as revenue streams, cost drivers, and customer turnovers, the software highlights strengths and weaknesses and empowers firms to make better decisions about where to focus resources for improved efficiency.

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

a. **Auditing**

One example of how Splunk might be utilized in auditing is found in its ability to log physical and digital access and entries to maintain records of which individuals played a role in any event of interest. For example, if an auditor were seeking to inspect a discrepancy traced back within the physical facilities of a firm, Splunk would quickly provide a report of what employees accessed the location during the time of interest. Spunk performs a parallel role in acting as a watchdog of the digital realm, as the software chronicles anytime an internal or external actor contacts a firm's servers and databases. While this may provide evidence of those acting in bad faith, it can also simply ensure that employees who are supposed to be periodically checking into records are in fact fulfilling their responsibilities. Splunk's capabilities in this context would greatly ease the burden of auditors and assist them as they seek to examine discrepancies.

Because Splunk is an IT software in addition to a business information program, it possesses the ability to examine coding and run tests on a firm's current security systems. By scanning a company's current digital setup for security gaps, Splunk can identify points of compromise and stop an attack before it takes place, rather than simply report an already occurred breach. In addition to hedging against external threats, Splunk can identify insider threats lurking with the organization's infrastructure that often go unidentified until a mess is already made for an auditor. By approaching security from a software and IT perspective, Splunk empowers auditors with a greater and more preemptive oversight of a company's operations.

Another value added to auditing teams is Splunk's constant examination of transactions for red flags. The software is intelligently designed to notify auditors any time a transaction that may be a source of concern takes place; it can immediately notify auditors when an event takes place, meaning auditors are enabled to act in real-time and cut out issues before they proliferate. Auditors can also utilize Splunk to manually set watchlisted events should there be a particular interaction of interest. By acting as a sentinel, Splunk can be of great assistance to auditors as they seek to maintain order within a firm's records.

b. Tax Planning

Splunk's aggregation of data and indexing of overarching trends enables firms to make more strategic decisions as they plan for taxation. One example of Splunk's value in this category is its ability to track multi-channel revenues from a variety of sales, including the sales of inventory and the provisions of services. Further, it can analyze each stream of revenue to examine critical components of each source such as the

validity, profitability, and collectability of each. By providing insight into a firm's variety of revenues, tax planners can better determine the amount to write off, the amount to be deferred, and the amount be reported as income. This insight ensures that tax payment is accurate and minimized so that a company's net cash flow is greater, overall improving their liquidity and market positioning.

Similarly, Splunk can measure the timing and origins of revenues so that they can be examined and simulated in a variety of tax situations. For example, the physical locations of revenues can dramatically impact the profit margin depending on the legislated tax rate in the region where the transaction takes place. However, with Splunk, companies can gain a better understanding of where their revenues are originating and where their tax obligation is highest; by then deciding to invest in geographic centers with favorable tax burdens, tax planners can identify tax havens and utilize prudent tax avoidance.

Splunk can also assist firms in the strategic planning of depreciation charges by monitoring facility maintenance so that degradation is accurately forecasted, enabling firms to make better decisions about asset management and depreciation expensing. In addition to accumulating inputted data, Splunk can generate data itself using its specialized insights into server health. It has been developed to accurately forecast degradation and project asset life by examining metrics like trends in server responsiveness and behaviors in reply to stimuli such as temperature changes. By creating data for server health, and incorporating data that monitors other assets, Splunk can play a key role in allocating depreciation over time in an effective manner that more accurately reflects the expenses a company faces from asset degradation. When this

ensures assets (especially IT equipment) aren't under-depreciated, it alleviates a firm's tax obligation and improves net cash flow for the present period.

3. **Write a few paragraphs in memo format 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.**

To: Future Co.

From: Shane Ferrero

Re: **Recommendations for Investment in Splunk Software**

After conducting research and analysis, I have come to the conclusion that the capabilities presented by business information software Splunk would greatly enhance our current operations. Let me briefly expound on why I recommend our company invest in Splunk.

Splunk possesses a powerful ability to gather data across a variety of contexts. From the recording of sales and the logging of trade transactions, to the examination of asset health and indexing of overarching data trends, Splunk provides a central tool for our company to store machine-generated data and extrapolate valuable insights. The software will enable us to search, monitor, and analyze a great deal of data that is arising from our current operations, yet going unmined and uninspected. Splunk will do the heavy lifting for us as we seek to scrutinize the data; its ability to generate graphs, alerts, reports and visualizations will quickly enable us to make more profitable decisions across the board.

By analyzing a variety of key metrics, such as revenue streams and cost drivers, Splunk will allow us to comprehensively understand how to better allocate our resources.

Splunk will prove to be a wise investment for our staffing across a broad scope of environments. It will enable teams working in roles such as financial forecasting, market research, and security maintenance to do their jobs more easily and effectively. In fact, it is foreseeable that the increases in labor efficiency alone will recoup the cost of investing in Splunk, as employees without a professional background in data analysis or management information systems will still be able to utilize Splunk to improve performance. No specialization is needed to quickly pick up Splunk and use it for operation improvement; instead, its Web-friendly design is intuitive so that employees across departments will be able to understand and utilize captured and indexed data in real-time. We won't need to hire an outsourced specialist to understand our own data. The benefits of Splunk are immediate and far-reaching.

The software has been characterized as cutting edge in recent reports by the New York Times and the Wall Street Journal, and the market seems to agree, as Splunk's stock has risen exponentially over the last year with a 98% return. A software application such as Splunk is proving to be critical as businesses develop in the era of big data, and quickly learning how to utilize our enormous amount data for an advantage over competitors will prove critical to our success. By facilitating improvements in data management, resource allocation, and labor efficiency Splunk would surely prove to be a worthwhile investment for our company.

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Rocky Mountain Chocolate Factory

Shane Ferrero

Accy 420

Dr. Dickinson

12 September 2018

Summary
This case study had us look into Rocky Mountain Chocolate Factory, specifically examining a number of transactions that took place during their business cycle and identifying affected accounts. Subsequently, we were able to prepare a set of financial statements for the company's fiscal year. The case study utilized an understanding of the accounting equation so that each transaction balanced in its impacat on Rocky's accounts; it also emphasized the accounting cycle, as we deliberated through the process of making adjusting entries as well as closing entries for a finalized set of figures. We examined how the various pieces of financial informationare related to each other and are incorporated into financial documents, and in particular, we learned how Excel's software enables accountants to quickly prepare reports linked to a master journal using equations and cell references.

Question A
After reading about the nature of this company's operations, I expect to see assets such Cash, Short-term Investments, Receivables, Property Plant & Equipment, and Trademarks. Major liability accounts most likely include Accounts Payable, Notes Payable, Interest Payable, and Unearned Licensing Fees.

Question E
Three adjusting entries that might need to be made include an adjustment to deferred income (in the instance that some of the unearned franchising fees were to be recognized), a reduction in expected accounts receivable should any be written off, and a reduction in net PPE for depreciated & amortized assets.

Transaction #	Category
1	Operating
2	Operating
3	Operating
4	Operating
5	Operating
6	Operating
7	Operating
8	Operating
9	Investing
10	Financing
11	Non-cash
12	Non-cash
13	Non-cash
14	Non-cash
15	Non-cash

Transaction	Account Titles		Dr.	Cr.
1	Inventory		$ 7,500,000	
		Accounts Payable		$ 7,500,000
2	Inventory		$ 6,000,000	
		Wages Payable		$ 6,000,000
3	Cost of Goods Sold		$ 14,000,000	
		Inventory		$ 14,000,000
	Cash		$ 17,000,000	
	Accounts Receivable		$ 5,000,000	
		Sales Revenue		$ 22,000,000
4	Accounts Payable		$ 8,200,000	
		Cash		$ 8,200,000
5	Cash		$ 4,100,000	
		Accounts Receivable		$ 4,100,000
6	Sales & Marketing Exp.		$ 1,505,431	
	Gen. & Admin. Exp.		$ 2,044,569	
	Retail & Operating Exp.		$ 1,750,000	
		Cash		$ 2,000,000
		Other accrued expenses		$ 3,300,000
7	Wages Payable		$ 6,423,789	
		Cash		$ 6,423,789
8	Cash		$ 125,000	
		Unearned Franchsing Fees (deferred income)		$ 125,000
9	PPE		$ 498,832	
		Cash		$ 498,832
10	Dividends Declared		$ 2,407,167	
		Dividends Payable		$ 3,709
		Cash		$ 2,403,458

Transaction	Account Titles		Dr.	Cr.
12	Cost of Goods Sold		$ 216,836	
		Inventory		$ 216,836
13	Depreciation & amort.		$ 698,580	
		PPE (net)		$ 698,580
14	Gen. & Admin Exp.		$ 639,200	
	Retail & Operating Exp.		$ 6,956	
		Wages Payable		$ 646,156
15	Intangible assets		$ 500,000	
				$ 500,000
Closing	Interest Income		$ 27,210	
	Sales		$ 22,944,017	
	Franchise and royalty fees		$ 5,492,531	
		Cost of sales		$ 14,910,622
		Franchise costs		$ 1,499,477
		Sales & marketing		$ 1,505,431
		General & Admin		$ 2,422,147
		Retail operating		$ 1,756,956
		Dep & amort		$ 698,580
		Income tax expense		$ 2,090,468
		Retained earnings		$ 3,580,077

Normal Balance	Account Titles	Beginning balance	1. Purchase inventory	2. Incur Factory wages	3. Sell Inventory for cash and on account	4. Pay for inventory	5. Collect receivables	6. Incur SG&A (cash and payable)	7. Pay wages	8. Receive franchise fee	9. Purchase PPE	10. Dividends declared and paid	11. All other transactions	Unadjusted trial balance	12. Adjust for inventory count	13. Record depreciation	14. Wage accrual	15. Consultant's report	Pre-closing trial balance	16. Closing entry	Post-closing (ending) balance
Dr.	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)	$ 790,224	$ 3,743,092					$ 3,743,092		$ 3,743,092
	Accounts receivable	4,229,733			5,000,000		(4,100,000)						(702,207)	4,427,526					4,427,526		4,427,526
	Notes receivable, current	-											91,059	91,059					91,059		91,059
	Inventories	4,064,611	7,500,000	6,000,000	(14,000,000)								(66,328)	3,498,283	(216,836)				3,281,447		3,281,447
	Deferred income taxes	369,197											92,052	461,249					461,249		461,249
	Other	224,378											(4,215)	220,163					220,163		220,163
	Property and Equipment, Net	5,253,598									498,832		132,859	5,885,289		(698,580)			5,186,709		5,186,709
	Notes receivable, less current portion	124,452											139,198	263,650					263,650		263,650
	Goodwill, net	1,046,944											-	1,046,944					1,046,944		1,046,944
	Intangible assets, net	183,135											(73,110)	110,025					110,025		110,025
	Other	91,057											(3,007)	88,050					88,050		88,050
Cr.	Accounts payable	1,074,643	7,500,000			(8,200,000)							503,189	877,832					877,832		877,832
	Accrued salaries and wages	423,789		6,000,000					(6,423,789)				-	-			646,156		646,156		646,156
	Other accrued expenses	531,941						3,300,000					(2,885,413)	946,528					946,528		946,528
	Dividends payable	598,986										3,709	(1)	602,694					602,694		602,694
	Deferred income	142,000								125,000			(46,062)	220,938					220,938		220,938
	Deferred income taxes	827,700											66,729	894,429					894,429		894,429
	Common stock	179,696											1,112	180,808					180,808		180,808
	Additional paid-in capital	7,311,280											315,322	7,626,602					7,626,602		7,626,602
	Retained earnings	5,751,017										(2,407,167)	-	3,343,850					3,343,850	3,580,077	6,923,927
	Sales	-			22,000,000								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)	-
Dr.	Cost of sales	-			14,000,000								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	(1,505,431)	-
	General and administrative	-						2,044,569					(261,622)	1,782,947			639,200		2,422,147	(2,422,147)	-
	Retail operating	-						1,750,000					-	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)	-

Rocky Mountain Chocolate Factory, Inc.			
Income Statement			
For 2010 Fiscal Year			
Revenues			
	Sales	$ 22,944,017	
	Franchise and royalty fees	5,492,531	
	Total revenues		$ 28,436,548
Costs and Expenses			
	Cost 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 income	$ 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
Weighted Average Common Shares Outstanding			6,012,717

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

Assets		Liabilities and Stockholders' Equity	
Current assets		**Current Liabilities**	
Cash and cash equivalents	$ 3,743,092	Accounts payable	$ 877,832
Accounts receivable	4,427,526	Accrued salaries and wages	646,156
Notes receivable, current	91,059	Other accrued expenses	946,528
Inventories	3,281,447	Dividends payable	602,694
Deferred income taxes	461,249	Deferred income	220,938
Other	220,163	Total current liabilities	$ 3,294,148
Total current assets	$ 12,224,536		
		Deferred Income Taxes	$ 894,429
Property and Equipment, Net	$ 5,186,709		
Other Assets		**Stockholders' Equity**	
Notes receivable, less current portion	$ 263,650	Common stock	$ 180,808
Goodwill, net	1,046,944	Additional paid-in capital	7,626,602
Intangible assets, net	110,025	Retained earnings	6,923,927
Other	88,050	Total stockholders' equity	$ 14,731,337
Total other assets	$ 1,508,669		
Total assets	$ 18,919,914	Total liabilities and stockholders' equity	$ 18,919,914

Careers in Accountancy

Shane Ferrero

Accy 420

Dr. Dickinson

19 September 2018

Executive Summary

For the purposes of this case study, we analyzed a handful of situations that might arise in the pursuit of a career in accountancy and related business fields. By examining these hypothetical circumstances, we were able to view a variety of professional paths from a variety of perspectives, employing academic, professional, and personal lenses. For the first business situation, we examined how an undergraduate study of accountancy might prepare an individual for law school and a career in tax law. There were unique advantages presented to both of the alternatives, and we explored how the paths compare in potential opportunities and career trajectories. For a second study, we looked at how a student bound for the field of finance might opt for a Bachelor of Accountancy rather than the conventional route of majoring in finance. I found this discussion particularly relevant, as I'm concurrently pursuing a degree in both Accountancy and Managerial Finance. Finally, we scrutinized how a student with a job offer in a particular city might be able to transition into a different location in a professional manner. The etiquette and advisory surrounding such an experience was particularly valuable, as it embodied a softer knowledge that we often forego in strictly academic settings.

By immersing ourselves in these scenarios, we were able to angle ourselves form a variety of perspectives with different values and emphases. Ultimately, we grew in our understanding of what factors influence professional development and the bases of strategically developing a career in accountancy and finance.

1. **A current accounting undergraduate student at Ole Miss is considering going to NYU for law school to pursue a career in tax law. Is this a prudent career choice, especially when compared to the option of going to a Master of Accountancy program instead?**

This situation mainly dealt with the comparison of an accounting graduate program and a law program, as the student is already sure of where he wants to end up eventually but needs to decide the best path for achieving his career goal of working in tax law. The argument for attending a graduate accounting program rests on the lower costs of tuition, as well as the shorter timespan required for completing the program. A Master of Accountancy can generally be achieved in one year of study, while a law degree often takes 3 years. While a student is focused on their studies, they often have little to no income and are reliant upon loans for the cost of living. Completing a Masters in a year and entering the work force sooner allows individuals to start earning money quicker and have a career that has already developed for two years before a law student graduates. Finally, it could be argued that a master's program is less risky than a law school, as immediate job placement rates tend to be higher for accountancy degrees than for law degrees.

However, the student in this case is set on going to NYU for law school, as his cousin currently attends the program and vouches for its value. This path requires greater time devoted to studies, but it offers a wide range of benefits as well. First, the starting salary in the field of tax law for someone with a law degree is $20,000 higher annually on average than someone working with only a master's degree. In a fairly short amount of time, this can offset the increased cost of law school, and provide greater earnings from

that point on. Further, going to law school exposes an individual to a new professional perspective and provides a great deal of networking connections along with increased opportunities that come from knowing a broad range of people across industry and geography. Plus, this student is already in line for an accounting internship; it can never hurt to have a multitude of opportunities unraveling before him! If the idea of law school in New York City appeals to this individual on a personal level, then it's certainly a justifiable route. It's worth noting that many law degrees offer the option of pursuing a Master of Accountancy and a J.D. concurrently, obtaining both degrees at the end of 3 years. Ultimately, attending law school can unravel a variety of opportunities to further his career and grow him as a professional.

2. **A student interested in a career in finance-related fields is opting to major in accountancy rather than finance. How might this choice increase his career prospects?**

The second situation presented to us focused on how a student pursuing a career in investment banking or financial consulting might choose to study accountancy rather than the conventional major of finance. This choice may seem counter-intuitive but may actually be wise for a few reasons. Primarily, the decision is prudent because an accounting degree is probably the most portable of all business degrees. An individual with an accounting degree can be easily hired for a finance-centered role, but a finance major couldn't easily transition into an accounting role. Although the saying is somewhat trite, it remains true: "accounting is the language of business." By studying accounting, students gain an exposure to the ins and outs of corporate operations and gain a fundamental understanding of the drivers of business activities. This would ring

especially true for this student, as she intends to intern in accounting as well. Although this professional situation could be complicated, as long as the student is transparent with their intentions, they could gain valuable professional experience in the field of accounting, and perhaps find openings for financial opportunities in accounting firms.

This study felt particularly significant to me, as I'm currently interested in a career in corporate finance, but also studying accounting. I'm currently working towards a double degree (B. Accy. & B.B.A. in Finance) and will graduate with both, as I feel this will provide me with the greatest momentum leaving Ole Miss. While finance is a better fit for my personal interests and professional goals, a degree in Accountancy seems to provide greater value and employability, especially at an institution such as the University of Mississippi where accountancy is so highly ranked. If it is at all possible for the student in this scenario, I would advise she study accounting and finance simultaneously.

3. **After completing an internship in Washington D.C., an accounting student determines they'd like to accept a job offer with a company, but work in Dallas instead. Can they request a transfer in a professional manner?**

The final situation we examined revolved around an accounting student in their final year of studies who had completed an internship the previous winter with a "big four" accounting firm in Washington D.C. Upon completion of the internship, they were offered a full-time job, available immediately after graduation. Because the student enjoyed the company and job role during the internship, they were interested in accepting; however, since the internship, this student had decided that Dallas was a more

desirable place to live. The dilemma posed to us was if, and how, a student might professionally seek to have a job offer transitioned into a different city.

Although it is understandable that the student could have a change of heart and desire to live in a different city than the place of his internship, they are a couple of key considerations to be taken into account. First, the company devoted a significant amount of resources towards recruiting and training the intern; the figure quoted to us in class was $150,000. Secondly, the student should be slow to assume that he has a strong understanding of the Washington D.C. area and how satisfied he might be living there; after all, an internship is only a couple of months, and it certainly takes longer than eight weeks to immerse oneself in all that a particular city has to offer.

Ultimately, the student should engage in a conversation with the recruiter as soon as possible. They should be understanding of the company's perspective and be patient with the company as it finds the capacity to manage his request. However, if he finally decides that living in Dallas is more important the professional cost of surrendering the lucrative job offer with a prestige firm, that's understandable too. Accountants seek to understand costs, and personal costs are just as legitimate as professional costs.

Accounting for Debt Securities and Impairments

Shane Ferrero

Accy 420

Dr. Dickinson

10 October 2018

Executive Summary

This case explored the treatment of available for sale debt securities, particularly when their fair values fall below their amortized cost on the books, resulting in impairment losses. Although these losses are generally hosted in a separate equity account (conventionally referred to as "accumulated other comprehensive income"), there may be times when it is appropriate for impairment losses to run through net income as a more accurate reflection of a firm's financial standing and operations. After researching financial guidance from the perspectives of accountancy guidelines, including the distinct provisions found in instruction for external auditing and bank regulators, it became evident that this decision is multivariate and complexly influenced by a variety of factors. Primarily, the consideration of impairment is affected by a firm's ability and intent to hold securities until they've recovered from impairment losses.

However, even in a situation where this assertion is maintained as valid, there may be times when a security's impairment is deemed to be in a loss position so significantly or for such a prolonged period of time that it is ultimately appropriate to recognize the impairment in the present time, as a recovery is not reasonably foreseeable. Auditors and regulators may differ from the firm in the evaluation of this judgment, as the interests of each party may be in tension with one another. Through the exploration of accountancy guidelines and the roles of each party in a process as such as this, I was able to learn not just about accounting for AFS debt securities, but also in a broader sense how competing parties may seek to establish different findings and financial treatments to favor their own goals.

1. **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 needs to recognize an impairment loss for five of the seven securities, as their fair values (and assumed sale prices) at the time of the transactions were lower than their amortized carrying value. Two of the securities (067 & 096) did not experience a loss upon the sale, as their fair values exceeded their book values; rather, these securities were accompanied by a gain on the sale of the securities. The losses that should be recognized, despite being actually sold in 20x3, should be presented on the 20x2 financial statements due to the facts that contextualize the sale. Because Generic Bank sought to use the proceeds of the sale for 20x2 operating decisions, and because the intention was evident before the preparation of 20x2 financial statements, the firm should recognize the accompanied losses in 20x2. This guidance finds its basis in ASC 320, which states that an impairment loss should be recognized in a prior period if the "security is sold shortly after the balance sheet date, and facts and circumstances suggest the decision to sell was made before the balance sheet date."

2. **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?**

No, the firm is not obligated to recognize impairment losses on other securities as a result of selling these seven. Because the company maintains an intent and ability to hold these items until they recover from their current unrealized losses, it is "more likely than

not” that the losses will never come to fruition - a basis established in ASC 320-10-35. The assertion that the firm has the capacity to evade materializing future impairment losses is backed by the fact that the company is well capitalized, has other methods of obtaining capital, and ultimately made a voluntary, strategic choice to sell these securities. The nature of their decision is reflected in the intended use of the capital, as the firm will use the money primarily for strategic acquisitions in the coming year and for non-mandatory employee compensation, not for the purpose of paying off outstanding debts.

In addition to the fact that the sale proceeds are for discretionary expenditures rather than compulsory expenses, the securities themselves have experienced losses due to the market interest rates rather than experiencing credit deterioration, and it’s most likely that they will eventually return to their book value. Finally, the sale of seven securities is proportionally insignificant relative to the number and value of securities remaining on the books; that is, it would require a stretch of imagination to suggest that the fate of just these seven securities provides significant insight into what may happen to the rest. In light of all of these factors, Generic Bank could reasonably opt not to recognize impairment losses on the other securities.

3. **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?**

a. If I’m assuming the role of an external auditor for Generic Bank, I’m inclined to approach Generic Bank’s financial situation with a greater level of skepticism. I would

likely accept their assertion that they have the ability to hold the securities until the recovery of impairment, considering they are currently well capitalized and able to receive capital from other sources if needed. However, I am likely to maintain doubts about their intentions, and both components must be present should Generic continue to maintain the impairment losses in an Accumulated Other Comprehensive Income. As an auditor, I'm unable to be certain that Generic's stated intent is transparently earnest, and I have a duty to affirm with reasonable assurance that the company's records are fair and materially true. Notably, the fact that they were willing to sell securities at a loss for the sake of discretionary spending casts a dubious light on their supposed intention to hold securities until recovery.

KPMG guidance provides instances where the auditor should force the firm to recognize impairment losses; the foremost of these examples include the "obligor experiencing significant financial difficulties," "the disappearance of an active market because of financial difficulties," and a "significant or prolonged decline in the fair value of an investment in an equity instrument below its cost." The former couple of qualifications are not evidenced in this situation; however, the latter condition is probably true of some securities within their portfolio. KPMG notes that neither "prolonged" nor "significant" are explicitly defined within FRS 139, the basis of its auditing guidelines, and therefore a judgment call is incumbent upon auditors.

In light of a broader understanding of what is deemed "prolonged" in the financial industry, I would find it reasonable to ascertain that securities with a loss continuing longer than a year could be considered impaired for a reasonably prolonged period. According to Generic's Dec. 31 20x2 Balance Sheet, $701.809 million of unrealized

losses are attributable to securities in a continuous unrealized loss position for greater than 12 months. However, the sudden relocation of this sum from AOCI to net income would be so drastic that I believe it would impair investor's abilities to understand Generic's financial positioning; this quantity is more than double 20x2's net income. If the auditor's goal is ensuring a fair treatment of the books, a distortion of this magnitude would be counterintuitive.

Because FRS 139 emphasizes not just the length of impairment but also the significance, I believe some methodology should be established to identify securities that are "significantly" impaired; that is, reduced below amortized cost to the extent that the improvement to book value isn't reasonably foreseeable. Perhaps this should include securities that have been reduced to more than 10 percent below cost, or maybe 20 percent; the number is difficult to identify as a number of environmental factors in the market are going to influence what amount is reasonable. Even the type of bond - municipal, MBS, or corporate - is going to invite further consideration in the analysis of reasonable fluctuation. Regardless, the tension I perceive in Generic's intentions conflicting with their actions, in junction with the prolonged impairment of some securities, would lead me to recommend that the auditor carefully facilitate the movement of some impairment loss into net income of securities that have been prolongedly and significantly impaired.

b. A bank regulator is going to be even stricter than an auditor in scrutinizing Generic's assertions. Because the regulator is seeking to ensure financial stability and a miscalculation on their part can lead to serious economic ramifications for investors, they

are going to be hesitant in permitting a firm to forego recording impairment in net income. Much like the auditor, a bank regulator is likely to be suspicious of Generic's claim of intent, as they have evidenced a willingness to sell impaired securities even when such sales were not compulsory. This somewhat frivolous attitude on display will undermine the legitimacy of their stated intentions, and bank auditor is likely to enforce impairment through net income on the books. However, the question remains as to what extent a regulator may take action.

Again, although no hardline rule can be drawn, there must be some bifurcation established in the gray area, as the Office of the Comptroller of the Currency instructs the implementation of "a systematic methodology for identifying and evaluating fair value declines below cost." In the 2018 Bank Accounting Advisory Series published by the OCC, factors that are cited for consideration in classifying AFS' impairment treatment include "the length of time and the extent to which the fair value has been less than the amortized cost" as well as "the historical and implied volatility of the fair value of the security." This approximately mirrors the emphasis on significance and duration found in FRS 139. Subsequently, I believe my previously exploration of these criteria pertains to the regulator's perspective just as it did for the auditor, and a system should be established that balances reasonability with caution in the determination of impairing some securities based on how long and far they have been impaired.

However, a bank regulator is most primarily concerned with capital ratios, and it's worth noting that allowing Generic to elect utilizing keeping losses in the AOCI account will not affect the net worth of assets on the books. Therefore, this issue is not as pressing

as it might immediately appear for the regulator in particular, and the treatment implemented by the regulator is likely to closely parallel that of the auditor.

4. How would your assessment 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?

This modification impacts the scenario greatly because it realigns the interests of Generic in how they determine treatment of differences between fair value and amortized cost. Now, they would likely enjoy the benefit of recognizing gains immediately through net income. However, principles should still be consistently utilized to ensure fair treatment and accurate representation of Generic's standing.

The conservatism principle in accounting suggests that gains shouldn't be recognized too eagerly, and this seems especially true in this situation as Generic themselves has claimed they don't intend to sell these securities in the near future. Further, Generic would need to be consistent in their treatment of the securities, and if they were going to move their unrealized gain from AOCI to net income, this must include the losses as well, meaning that the answers from 1 and 2 would definitely change. However, at this point, Generic would essentially be handling the securities as if they were trading securities. This is a potential option for Generic to explore, but it would require a reclassification, and assuming Generic is still stating their intention to hold securities, it is probably best that they continue to maintain these securities as AFS and gains run through an equity account other than net income. Therefore, the evaluation of impairment probably doesn't differ much from assessment #1 and #2, but it's going to be

contingent upon how Generic decides they would like to report the unrealized holding gains.

If every single security was in a gain position, it could be to Generic's favor to treat these as trading securities, assuming they want to increase net income. Regardless of treatment of gains, this situation differs greatly from the previously discussed findings as no impairment loss will be recognized at all when each security's fair value is higher than amortized cost.

5. Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 20x3, but rather than being well capitalized they're adequately capitalized. Additionally, they desire to sell securities to improve capital ratios and to fulfill other borrowing obligations as they come due, and access to other forms of borrowing has become more limited. Does Generic Bank have an impairment loss on securities other than the seven sold?

This situation casts Generic in a much more doubtful light, as it calls into question not just their intent to hold AFS debt until impairment recovery but also their ability. In the previous discussion of Generic's standing, they were selling securities for discretionary investments, but now it appears they could be selling securities to meet current liabilities. Further, they can't reasonably claim that their sale of securities was "strategic," since their options for obtaining capital have become limited. Both the claim to intent and the claim of ability are sitting on shaky ground. Generic's management of their securities portfolio in this scenario would closely mimic the possession of trading securities, as they're being sold on an operating basis. Subsequently, their classification of gains and losses needs to more closely exemplify the nature of these securities' role in

Generic's operations, and a significantly greater amount of impairment loss than aforementioned (if not all impairment loss) will have to be moved into net income to reflect the changes in Generic's positioning and foreseeable handling of the securities.

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City Selection

Shane Ferrero

Accy 420

Dr. Dickinson

7 November 2018

Executive Summary

The goal of this case study was to examine potential cities that we are likely to move to after college and gain a better understanding of what living in that city may look like, especially in components that we might not immediately consider, such as healthcare and transportation. By looking into all of the aspects of living in my chosen locations, I was able to gain a better sense of the professional opportunities available for me in the city as well as what it's like to live as a resident of those cities. The cities I chose were Minneapolis and Atlanta, which are greatly different in geography, but somewhat similar in their size and the nature of their economies. Ultimately, Atlanta seemed to offer a more conventional urban experience because of its huge population and urban development, but Minneapolis seemed more reasonable in its cost of living and its transportation. Further, the climate and location of Minneapolis appeals to me significantly more.

I think that if I were able to have my immediate choice, I would probably select Minneapolis, but the reality is that there might be more easily accessible opportunities for Ole Miss graduates in Atlanta. I could see myself enjoying living in Atlanta for a little while after college, and because I intend on attending graduate school down the road, I would be satisfied with the situation found in Atlanta for a few years. Still, I might end up in a location completely different from both of these cities – and that's alright as well. Often times, careers are developed by capitalizing on opportunities as they present themselves. Regardless of where I end up after graduation, a thoughtful analysis of all factors equips me to make the most prudent choice, and the approach developed and utilized in this case study is a great place to start examining a professional relocation.

Minneapolis, Minnesota

1. The population of Minneapolis is about 422,000 within the city and around 3.6 million in the greater metropolitan area. I think the size of Minneapolis and its surrounding area is appealing because the area is large enough to provide the experience of a city and the opportunities that come along with it, but it's not overpopulated or too dense, as its population density is about 7,700 people per square mile compared to New York City's 28,000 per square mile.
2. The climate of Minneapolis is marked by mild summers and harsh winters. The average temperature in the summer is around 75 degrees Fahrenheit, while the winter's mean daily temperature is about 25 degrees Fahrenheit. It tends to snow often with an average 54 inches of snow each winter. Typical for a continental climate, there is a great deal of seasonal fluctuation with the difference in between the peak of winter and the peak of summer being an average of 60.1 degrees. I grew up in the Midwest and moved to the South when I was 18, and I have spent enough time in Mississippi to know that I strongly prefer the cold to the hot. Although the winter would surely be grueling at times, I would enjoy the climate overall, especially compared to living somewhere with the weather of Oxford.
3. Minneapolis is surrounded by a variety of forms of water, and even derives its name from the Sioux word for water. The city rests on an aquifer and hosts several lakes nearby; it is also located on the Mississippi riverbed. Within the metropolitan area, there are twelve lakes, three large ponds, and five wetlands. The terrain of the area is relatively flat. The urban area within Minneapolis is highly developed and boasts well-built infrastructure and many skyscrapers. I

appreciate the cityscape and geography of the area.

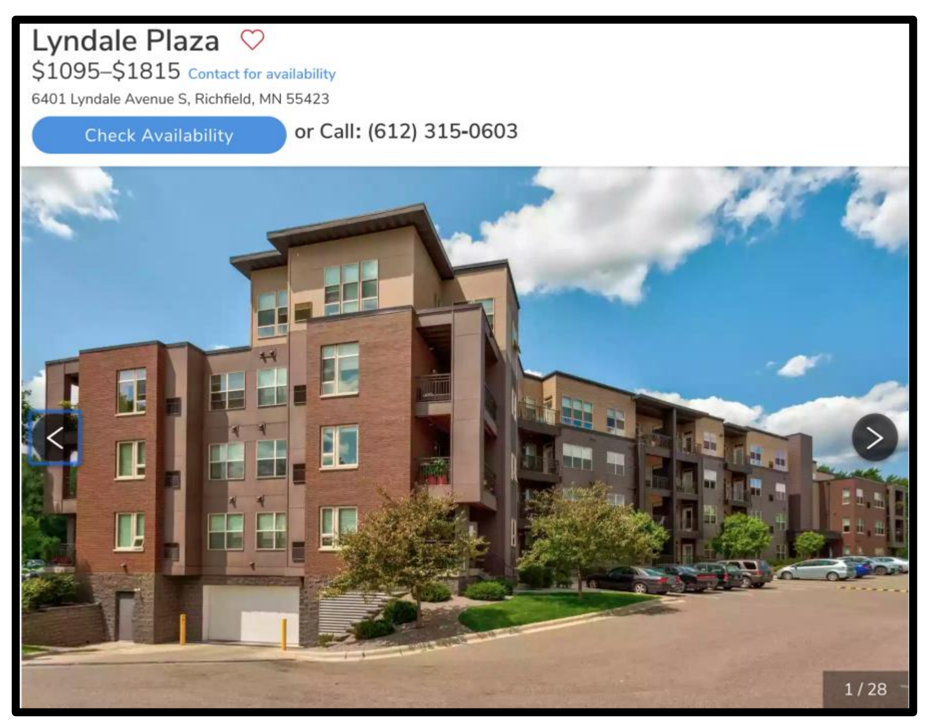
4. The state sales tax is 6.875 percent, and once Minneapolis' local sales taxes are included, the effective rate is 8.025 percent. The federal income tax would be around 25 percent for a gross income of $50,000, and Minnesota would impose another 7.05 percent of state income tax on top of that. A salary of $50,000 in Minneapolis would result in an after-tax income of about $39,461. Owning property within the city would also result in a property tax that would hover around 2 percent, depending on the market value. There also may be fuel taxes imposed in parts of the area, but these are generally marginal. Overall, the taxation of Minneapolis is probably a little steep compared to other living situations in the United States but not bad for a highly developed urban area.
5. Minneapolis offers all forms of transportation that could be expected within a U.S. city. There are multiple rail lines that run above and through the city,

including to the airport. The Minneapolis-Saint Paul International Airport connects to most U.S. major urban centers. Driving is very feasible relative to other major U.S. cities, and 60 percent of Minneapolis citizens said they drive to work personally. In 2011, the city was also ranked as one of the most walkable cities in the country, and there is even a Minneapolis Skyway System of elevated bridges between large buildings downtown that spans 80 blocks. The area is also full of taxis, Ubers, and Lyfts. I'm not disinclined towards using public transportation if I were to live in Minneapolis, and considering all of the factors, getting around sounds fairly easy compared to what it could be.

6. The economy of Minneapolis is large and robust, being the third largest economic center in the Midwest. Financial services is a large industry within the city, with Fortune 500 companies Ameriprise, U.S. Bancorp, and Financial Thrivent being headquartered downtown. One of the nation's 12 Federal Reserve Banks is also hosted in Minneapolis. The retail industry also accounts for a large portion of Minneapolis' economy; Best Buy and Target both find their corporate headquarters in the city. Overall, the gross metropolitan product is measured at $200 billion, accounting for about 70 percent of Minnesota's economy. The employment and growth numbers of the city's economy are on par with the country, and it has displayed strong recovery since the 2008-2009 recession. I would be excited to start a career in a city like Minneapolis with many promising opportunities for a finance & accounting major.
7. Minneapolis has a dependable health network, with seven hospitals located in the area, and four of them being ranked by U.S. news as among the best in the

country. There is also a Mayo Clinic 75 minutes away by car, and a Level I Trauma Center within the city. I would have no concerns about access to healthcare within the city.

8. Minneapolis is not a particularly safe place to live, with the FBI reporting it as one of the fifty most dangerous places to live in the United States. The Wall Street Journal reported robbery as the most common violent crime in the city, with Minneapolis being the tenth most common U.S. city for robberies to take place. The area of Minneapolis to avoid is the North side, specifically Uptown and Jordan. I am not very surprised by these findings, but if I plan on moving to a city in the Midwest, Minneapolis is a lot better than St. Louis or Detroit.
9. There's a good chance I would end up living near the Richfield area if I were to end up moving to Minneapolis after college. Apartments in this area are around $1100/month for 1 bedroom, around 650 square feet, but it would be easy to find roommates and go in on a 3 bedroom for about $1800 on about 850 square feet, meaning $600/person. Parking would be difficult directly within the city, but if you were to move towards an area like Richfield, the suburbs would allow for less costly parking arrangements. Utilities average around $125/month for an apartment and internet can be found at about $60/month.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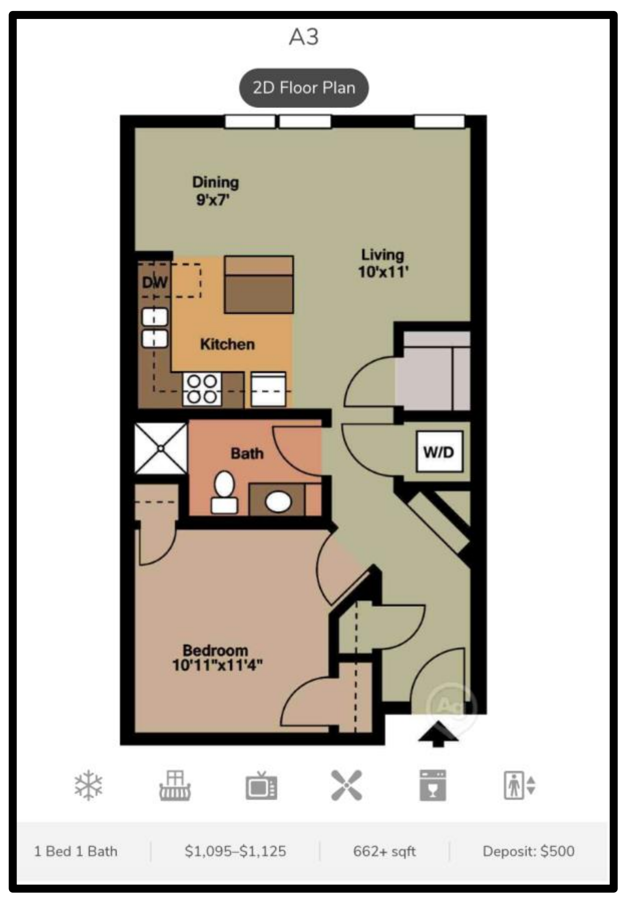

A3
2D Floor Plan
Dining
9'x7'
Living
10'x11'
DW
Kitchen
Bath
W/D
Bedroom
10'11"x11'4"
1 Bed 1 Bath
$1,095–$1,125
662+ sqft
Deposit: $500

10. The most common form of commuting is driving. If I were to work in the city and live in a suburb, or vice versa, the commute would be 20-30 minutes in light traffic. If I were to hit rush hour, this could result in taking an hour or so to get around, but that's to be expected with city living.
11. I would most likely do my grocery shopping at Kroger or Aldi, or possibly even somewhere like Costco. When it comes to groceries, I'm more of a cost-conscious consumer rather than worried about purchasing luxury products. In terms of my budget, I'd be inclined to save money by cutting my budget on groceries. The cost of groceries in Minneapolis is greater than the national average but still within reasonable limits.
12. The apartments in the area I was looking at tended to have laundry units provided within the apartments. The area is not as dense as some other metro areas, so it's

fairly easy to find complexes that accommodate residents with laundry appliances compared to other cities like Chicago or New York.

13. If I were to move to Minneapolis, I would definitely want to be a part of a local church. I'm familiar with a pastor at Bethlehem Baptist Church, so I'd likely start there although there are a variety of churches to become involved with in the city. There's also a large nonprofit in the city, Refugee Life Ministries, that works to assist refugees who often come here with no resources and know nobody in our country. I think that would be a great opportunity. There's also a non-profit called Hope Ministry where volunteers can tutor students in the underserved parts of the city. I think this is a cool cause and an important way to work with parts of the community that have historically been left behind.
14. Minneapolis offers tons of opportunities for entertainment. Almost any major musical artist on tour will make a stop in Minneapolis or St. Paul. Going to concerts is probably my favorite activity for entertainment, and I often drive several hours to see my favorite artists, so living in a city where they come to me would be convenient. The Film Society of Minneapolis St. Paul puts on a large film festival each spring, with several tens of thousands attending. The Orpheum Theatre hosts a variety of plays and musicals throughout the year, often with great production value. In terms of sports, Minneapolis is home to an NBA team, MLB team, NHL team, and NFL team. There are also collegiate sporting events through the University of Minnesota's teams. Lastly, St. Paul and Minnesota are both home to a variety of comedy clubs. All of these activities would ensure there's always something to do in Minneapolis.

15. Driving back to my hometown of Peoria, IL would take a little under 7 hours, which is definitely reasonable and less than my current drive at college. Delta also offers roundtrip flights for $315 throughout the week, so if for some reason I were to need to get home quickly, the possibility is still always available. I'm comfortable with the distance that would result from living in Minneapolis.

16.

Monthly Budget	
Housing	**750**
Groceries	**250**
Cell Phone	**80**
Electric / Gas	**30**
Water / Sewer / Trash	**15**
Netflix, Hulu, & Spotify	**30**
Internet	**25**
Transportation	**280**
Cosmetics and Laundry Supplies	**55**
Insurance	**255**
Restaurants	**300**
Income Taxes	**256**

Tithe	500
Entertainment	200
Gifts (birthdays, weddings, holidays)	100
Clothing	300
Miscellaneous Expenses	574
Savings and Investments	1,000
Total	5,000

17. After learning more about the Minneapolis area, I would still be interested in living there. It may be difficult to find opportunities there right after graduating from the University of Mississippi because of the geographic distance, but I still find it to be an appealing place to live. There's a good chance I would aim to end up there eventually, even if it means down the road such as after completing graduate school somewhere closer to the area. Minneapolis is probably the leading contender for my preferred city, even if it's not the most likely in terms of a quick and easy transition.

Atlanta, Georgia

1. The population of Atlanta is 420,000 within the city and 5.8 million in the greater metropolitan area. This is possibly a little larger than I would immediately prefer, but I still think living in a major city after college would be a cool experience.
2. Atlanta has a warm climate compared to most of the United States. The summer is marked by months with highs in the 80's, and the winters can get down into the

30’s. There is less seasonal variation than cities that are more northern. Snowing usually only occurs a couple of times per year, but there is usually about 50 inches of rain per year. Overall, Atlanta is best categorized as hot and humid. I’d rather avoid this climate, but it would be tolerable if I ended up in the area.

3. The geographic region encompassing Atlanta is home to a great deal of forestry due to its climate. Atlanta itself is an old enough city that much of the forestry within it has been excavated, but the surroundings of the city are still marked by thick trees and wildlife. A dense canopy of trees tends to expand into the suburbs, and the city has sought to preserve the canopy by imposing high taxes on project developers who remove trees. The city is found among the foothills of the Appalachians, and its fairly elevated for a city (1,050 feet above sea level). At the edge of the city, there is a river habitat that’s been well preserved. The varied geography of the area would allow for some cool experiences that might be more

difficult to find in other cities.

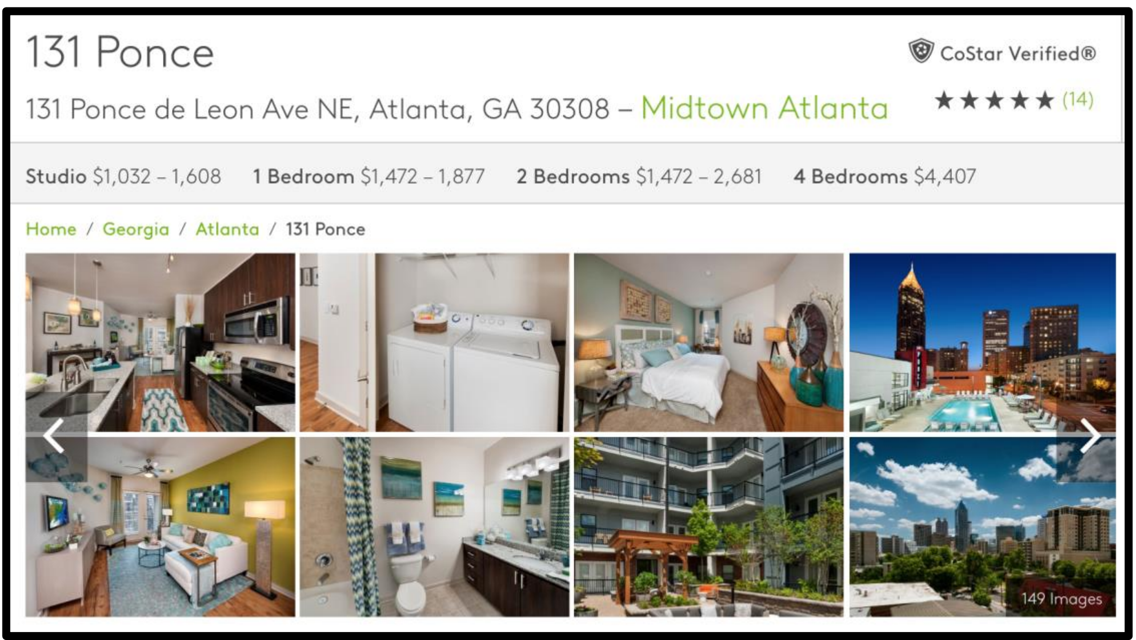
4. State income taxes in Georgia are 6 percent on a $50,000 salary, meaning after federal and state income taxes, a person with that salary would bring home approximately $39,165. Georgia as a state charges a tax of 4 percent on sales, and with Atlanta's local taxation, an effective rate of 8.9 percent would be imposed. The average property tax in Georgia is 0.93 percent. Atlanta's taxes would tend to be lower than what I might expect in a city of its size.
5. Atlanta has a heavy rail system throughout the city, as well as buses and a large Amtrak station. Atlanta's interstate is highly developed, with some of the busiest connection roads in the country. Its airport is the busiest in the world and offers flights to practically anywhere I could need to fly. The city's subway system also experiences high traffic, with it being the eighth busiest in the country. I think

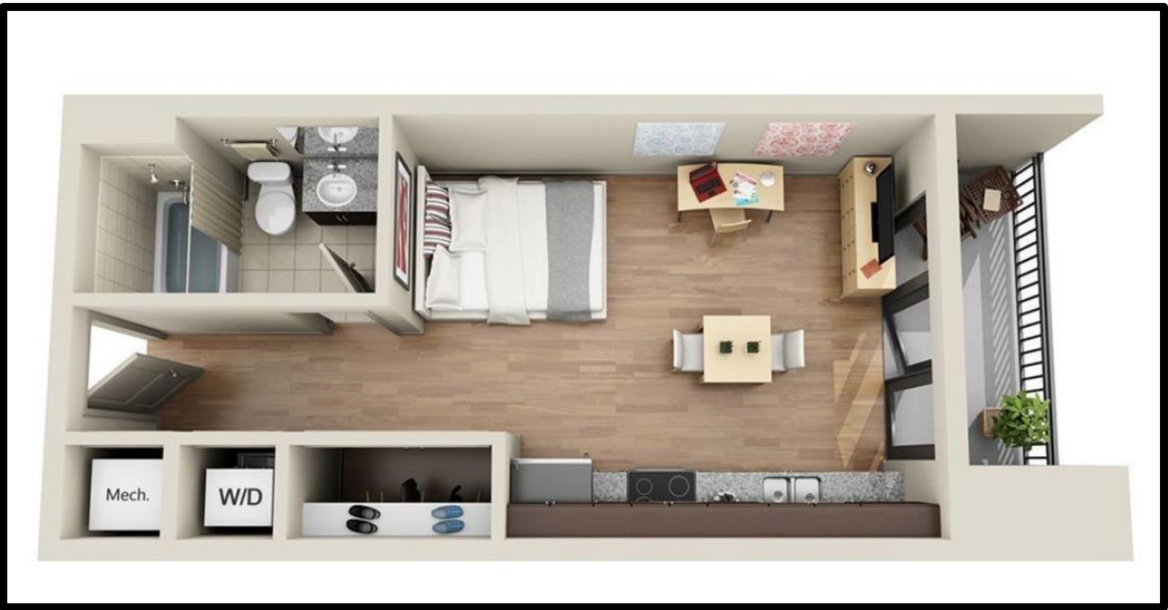
transportation has a lot to offer in Atlanta, but the high traffic could make driving a painful experience.

6. Atlanta's economy is massive, accounting for the 18th largest out of all cities worldwide. Transportation and logistics represent an integral part of the city's economy, as the hub has historically served as a connection point for the country's shipments. The media industry also plays a huge role in Atlanta, with Time Warner and CNN being headquartered in Atlanta. Increasingly, film and television production is moving towards Atlanta. The workforce of Atlanta is especially educated for a major urban area; 45 percent of adults 25 years and older have a bachelor's degree or higher compared to 28 percent nationwide. Several Fortune 500 companies are headquartered in Atlanta, including Coca-Cola, Home Depot, UPS, and Delta. I would gravitate towards Atlanta for the ample career opportunities to be found in the city and its network.
7. Atlanta's healthcare is considered to be highly advanced, as Emory's healthcare network within the city provides some of the best resources in the country. Specifically, Emory's heart center is one of the top-ranked in the world. The Grady hospital is one of the largest Trauma 1 centers in the country. There are 10 hospitals throughout the city, meaning lack of access to healthcare should never be a concern.
8. Atlanta has experienced significant issues with violent crimes in recent history, especially in gang-affiliated contexts. Shootings and stabbings have become a serious concern for residents, and those in Atlanta have to be careful where they go within the city. The Wall Street Journal recently reported Atlanta as one of the

five most dangerous cities in the United States. The downtown region has a reputation for being particularly violent, especially Five Points. The area surrounding the airport also experiences a high number of reported robberies and pickpocketing each year. If I were to live in Atlanta, I would need to be cognizant of where I live and travel.

9. If I were to live in Atlanta, it sounds like Midtown would be a really nice place to be. Much of the younger crowd tends to populate the area, and the area is where many of the cultural and entertainment-centered facilities are hosted. Rent in the area can definitely be pricey though; a one-bedroom can easily run upwards of $1500 for monthly rent. Studio apartments are also available, and these are more reasonable at around $1100/month, if cramped at 400 square feet. If I were to get a couple of roommates, I should be able to get rent down to $900/month for 1000 square feet with a little bit of searching. Parking could incur additional costs, so contingent upon my location relative to my workplace, I might opt out of keeping a car in the city. Utilities cost on average $160/month, and internet would cost about $60/month. Rent in this situation would probably be higher than I would be immediately comfortable with, but for the experience of living in Midtown for a few years, compared to other parts of the city, I think it would be worth it.





10. Many Atlanteans drive to work, but it sounds like driving is a nightmare if you get stuck if you attempt traveling at any time remotely close to rush hour. Therefore, I would try to live in Midtown and commute using public transportation or walking whenever possible. Even biking begins to sound appealing in a city like Atlanta.

Depending on location, getting to work would most likely require driving, but Atlanta would definitely be a city where I'd have to play it smart. The commute is going to be one of the biggest challenges of living in Atlanta.

11. Atlanta has several Walmart within the city, and I would most likely try to do the majority of my shopping there. As I previously discussed, I'm fairly indiscriminate when it comes to grocery consumption, and I'd rather save some money here by buying generic goods. I wouldn't see myself going to Whole Foods or Fresh Market regularly; I'd rather save my budget for other expenses. The cost of groceries in Atlanta is about on par with other major U.S. cities.
12. Most apartment complexes are either going to offer in-unit laundry appliances or some central location where I can launder my clothes; in the event that I ended up at a complex without this availability, I would have to go to a laundromat. I would strongly prefer avoiding that situation though, and almost certainly would stick with the rentals that accommodate laundry.
13. If I were to move to Atlanta, one of the first things I would want to do is become involved with a church. One of the first churches I found that's affiliated with my particular religious ideology is Midtown Church, and this would also be close to my hypothetical residence. A charity called Gateway Center seeks to relieve the homeless epidemic in Atlanta and enable the underprivileged to lead better lives. Also, the Ronald McDonald House has a large presence in Atlanta, and I think their cause is really cool. I'd be excited to be involved in all of these efforts.
14. Atlanta is going to have a huge number of concerts all of the time, and this would be the entertainment activity I'd be most excited to engage. The Atlanta Film

Festival takes place each year in the spring, and the Horizon Theatre and Fox Theatre host plays frequently. Atlanta is also home to the Falcons, the Braves, and the Hawks, so there are many opportunities to go to professional sporting events. There are more than 30 institutions of higher education in Atlanta, and the academic presence would attract speakers and events into the city. Beyond the few I've mentioned, there are many opportunities to stay entertained in the city.

15. The drive from Atlanta to Peoria, IL is 10 hours long, so trying to get there by car would essentially be a day-long trip. Delta offers round-trips throughout the week for $327. Although it would be somewhat inconvenient when I wanted to go visit family, it would be conceivable if the right opportunity arose to live in Atlanta.

16.

Monthly Budget	
Housing	1,000
Groceries	260
Cell Phone	80
Electric / Gas	40
Water / Sewer / Trash	20
Netflix, Hulu, & Spotify	30
Internet	20
Transportation	300

Cosmetics and Laundry Supplies	**55**
Insurance	**255**
Restaurants	**350**
Income Taxes	**221**
Tithe	**500**
Entertainment	**200**
Gifts (birthdays, weddings, holidays)	**100**
Clothing	**300**
Miscellaneous Expenses	**269**
Savings and Investments	**1,000**
Total	**5,000**

17. After examining the various facets of life in Atlanta, I think I would be able to enjoy and appreciate it for a period of my life. It's probably not my top choice, but I think it would be a realistic location for me to relocate considering the concentration of opportunities in the South after graduating from the University of Mississippi. If I were going to stay in the South, Atlanta would probably be my top choice. Although the climate definitely isn't ideal, and the traffic would present a challenge, the urban living offered by Atlanta is enough that it would make the net experience worthwhile.

WorldCom Inc.

Shane Ferrero

Accy 420

Dr. Dickinson

16 November 2018

Executive Summary

This case examined the underlying principles of capital expenditures and how various treatments, both proper and improper, can impact the financial statements of an entity. Specifically, this case looked into the now defunct WorldCom Incorporation and their mishandling of a particular expense. The transient nature of this expense was discussed and placed in relation to FASB guidance to analyze when an expense can be capitalized into a long-term asset for a company and when it must be immediately recognized as a detriment to equity. WorldCom took an expense that should have incurred immediately as it related to past and ongoing revenues, and the company erroneously and fraudulently crafted an asset account. Because FASB outlines that the standards for capitalizing an expense rely on the projection of probable future cash flows arising from the expense, WorldCom's actions were improper.

Beyond the research of these guidelines, the case also looked at how improper treatment can influence and develop errors within the financial statements. The balance sheet and income statements specifically are affected by the errors because of their shifting of expenses and subsequent reallocation of income over years. The statement of cash flows is also minorly affected because the cash outlay is improperly moved to the investing section of the statement rather than the operation portion. These errors distort the reporting of a company's financial positionings, and in the extreme case of WorldCom, result in the company being falsely reported as profitable for the current year. Overall, this case study displayed the importance of proper accounting treatment, as errors and fraud can produce catastrophic inaccuracy in a company's books.

A. i. What is the definition of "asset" and "expense" according to SCON 6?

According to SCON 6, assets are resources that are likely to give rise to economic benefits in the future of a business's operations. Assets are controlled by an entity and should arise as a result of the business's prior transactions and activities.

Expenses are the costs that are incurred throughout the course of a business's central operations. FASB clarifies that they result in either the reduction of a company's assets or the assumption of a liability.

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

FASB outlines that costs should be capitalized when they give rise to probable future economic benefits. However, costs are typically related to an ongoing or previous operation or service. In these instances, costs should be recognized as expenses.

B. 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.

Costs that are capitalized should be implemented with a system that depreciates or amortizes their value over the period of their life. Under the depreciation system, the balance sheet maintains a higher value for assets and equity accounts because the expense has been delayed. Over time, the assets and equity will be reduced due to depreciation costs. At the end of the asset's useful

life, the account balances should be equal to what they would have been under a system that immediately expensed the costs.

Likewise, the income statement under capitalization will have a greater bottom line in the most immediate periods, but if the capitalized costs are being reduced over the course of their lives, then the income statement in subsequent periods will actually experience lower income due to the prolonged expense.

C. What did WorldCom report as line costs for the year ended December 31, 2001? Prepare the journal entry to record these transactions and explain what these "line costs" are.

For the year ended December 31, 2001, WorldCom reported a line cost expense of 14.739 billion USD.

Line Costs 14,739,000,000

Cash or Accounts Payable 14,739,000,000

Line costs are the expenses that the company incurred in paying the owners of existing telecommunication networks to use their lines.

D. Describe the types of costs that were improperly capitalized at WorldCom. Explain what transactions gave rise to these costs and whether or not these meet the definition of an asset as described in part a.

A large portion of the aforementioned line costs were capitalized on WorldCom's balance sheet. WorldCom was paying the owners of telecommunication lines fees to complete calls utilizing those lines. This fails to

meet the standard for capitalizing a cost, according to the previously established standards. A cost should only be capitalized into an asset when it's expected to give rise to future economic benefits, and in WorldCom's situation, they were paying an expense that was related to their ongoing and already completed services. Therefore, it was an improper treatment of line costs; the entirety of these expenses should have been immediately recognized and incurred.

E. 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?

PPE..3,055,000,000

Cash or Accounts Payable 3,055,000,000

These costs will appear on the balance sheet through an increase in affected asset accounts (PPE). On the statement of cash flows, the costs will still result in a reduction in net cash flow and will appear under investing activities (as they were improperly recorded as an investment in capital).

F. In a sworn statement to the Securities and Exchange Commission, WorldCom revealed details of the improperly capitalized amounts (in millions) in 2001: $771 in the first quarter, $610 in the second quarter, $743 in the third quarter, and $931 in the fourth quarter. 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 (or costs capitalized). Calculate the related depreciation expense for 2001. Prepare the journal entry to record this depreciation.

Useful life (midpoint of the range for transmission equipment): 22 years

Period	Capitalization	Periods of useful life (88 quarters)	Resulting depreciation
1st Quarter	$771 million	4/88	$35.05 million
2nd Quarter	$610 million	3/88	$20.80 million
3rd Quarter	$743 million	2/88	$16.89 million
4th Quarter	$931 million	1/88	$10.58 million
2001 Total	$3,055 million		**$83.31 million**

PPE..83,306,818

Cash or Accounts Payable 83,306,818

G. Using the answers to parts e and f above, 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 calculations. State any other assumptions you make. Is the difference in net income material?

Expenses under proper treatment	$(3,055,000,000)
Expenses under improper treatment	(83,310,000)
Additional expenses to be recorded	(2,971,690,000)
Reduction in tax liability (35%)	1,040,091,500
Adjustment to net income	(1,931,598,500)
Improperly reported net income	1,500,000,000
Actual net income (loss)	(431,598,500)

Expenses that arose as a result of their improper treatment of line costs can be assumed to be the calculated depreciation expense of $83.31 million. However, the correct handling of line costs would have produced an immediate expenditure of $3,055 million. The difference that occurs between these two systems amounts to approximately $2,971 reflected in gross income. If the marginal tax rate is 35%, then the company would have faced a lower tax liability due to the higher losses faced on the immediate expenditure of the line costs, meaning there would be an after-tax income reduction of approximately $1,932 million. This value of $1.932 billion, in comparison to the reported net income of $1.5 billion, is most certainly material. Net income should then be reported as a net loss of approximately $432 million.

Starbucks

Shane Ferrero

Accy 420

Dr. Dickinson

27 February 2019

Executive Summary

In this case, we examined the structure of Starbucks through the nature of their operations and inner workings of their financial statement preparation. A variety of issues relating to the examination and assessment of Starbucks as an entity, especially surrounding their sizable legal charges faced in 2013, were explored throughout the case. Initially, an understanding of financial reporting in general and the typical statements released to external parties were discussed to contextualize how these various elements relate to Starbucks specifically. Further, the role an auditor plays in scrutinizing financial statements and internal controls was explored in order to illuminate the principle of reasonable certainty of material truthfulness in financial statements.

Although financial statements utilizing currency measurements are obviously necessary, common-size financial statements also provide a great deal of value for quick and clear financial analysis of a company's structure. The preparation of common-size income statements and balance-sheets highlighted the structure of Starbucks' financial holdings and composition of the company's financial activities as listed on the income statement. With each line entry reported as a percentage of the top line, the relative role each category played in the production of the bottom line is more accessible to those examining the statements. Lastly, we examined the role estimation plays in the creation of financial statements. While every effort should be made to ensure numbers are accurate and precise, the nature of business provides that there will be uncertainty and changing value relating to most accounts. Accountants must utilize sound judgement in order to craft reasonable estimations that will provide reliable financial statements.

Part A

Starbucks is a company that deals in the production and distribution of coffee products as well as the operation of coffeehouses across the world. The organization's primary generation of revenues is derived from the various facilities it runs using the Starbucks' name and product lines, but Starbucks also licenses its products to other companies and generates revenues through this channel as well. At Starbucks locations, consumers are able to order a variety of coffee roasts, specialty espresso drinks, and food products such as pastries and breakfast sandwiches. Besides the direct use of stores, another notable revenue channel is Starbucks' direct sales of its goods such as coffee beans and grounds in various retail chains.

Part B

The most commonly prepared financial statements for external parties are the income statement, balance sheet, statement of retained earnings, and statement of cash flows. Starbucks refers to its income statements as a "Consolidated Statement of Earnings," its balance sheet as "Consolidated Balance Sheet," its statements of cash flows as "Consolidated Statement of Cash Flows," and its statement of retained earnings as "Consolidated Statement of Equity." There is also a prepared "Consolidated Statement of Comprehensive Income" which comprehensively includes gains and losses that are classified as unusual or existing outside of standard operations.

Consolidated refers to the style and extent of the presentation of various elements. For these particular consolidated statements, line entries are grouped into related categories for simplification rather than listing the many various individual aspects of Starbucks' financial activities and positioning. Further, Starbucks owns or exerts a

controlling interest upon a variety of brands; rather than reporting these subsidiaries separately, they are included in with Starbucks' reports.

Part C

Most publicly traded companies release financial statements on a quarterly basis. These financial statements may be narrower in scope compared to the annual report, which is released on a yearly basis and filed with the SEC, often with extensive detail.

Part D

Starbucks as a publicly traded company bears the responsibility to prepare financial statements and ensure their integrity. In addition to Starbucks legal obligation, an external auditing organization is also required to provide an opinion on the validity of Starbucks financial reports, and this auditor bears a responsibility in the sense that they are accountable for the assessment they provide. The external reports are likely to be used by investors, including individuals as well as firms, to evaluate the profitability and future performance of Starbucks in order to evaluate potential investment opportunity. Profit margins and revenue growth rates are especially relevant metrics for potential investors. Another group who is particularly interested in Starbucks' reports is lenders. The creditworthiness of Starbucks can be illuminated by the data presented in financial reports, as ratios like liquidity and solvency are crucial to credit evaluation.

Part E

Deloitte & Touche in Seattle is the firm responsible for auditing Starbucks' financial statements and internal controls. The unqualified opinion letters provided by the firm state that through the completion of their audit process, they have reached the conclusion with reasonable certainty that Starbucks' financial statements are materially

true and that the company has gone to reasonable measures to ensure internal controls in relation to the preparation of its financial statements. Essentially, this communicates to investors that they can have confidence in the integrity of Starbucks and rely upon their financial statements as being an accurate representation of the company's position.

Both opinion letters are dated several months after the year-end because of the time it takes to thoroughly conduct an audit. The data to be audited is not yet available in its final form to the auditors until year end, and it can be a lengthy and extensive process to ensure a measured audit of all necessary components. This time gap accounts for the dates being several months after the fiscal year has concluded.

Part F

Common Size Income Statement

In Millions	**Sep 29 2013**	**Sep 30 2012**
Net revenues:		
Company-operated stores	79%	79%
Licensed stores	9%	9%
CPG, foodservice and other	12%	12%
Total net revenues	100%	100%
Cost of sales including occupancy costs	43%	44%
Store operating expenses	29%	29%
Other operating expenses	3%	3%
Depreciation and amortization expenses	4%	4%
General and administrative expenses	6%	6%
Litigation charge	19%	0%
Total operating expenses	104%	87%
Gain on sale of properties	0%	0%
Income from equity investees	2%	2%
Operating income	-2%	15%
Interest income and other, net	1%	1%
Interest expense	0%	0%
Earnings before income taxes	-2%	15%
Income taxes	-2%	5%
Net earnings including noncontrolling interests	0%	10%
Net earnings attributable to noncontrolling interes	0%	0%
Net earnings attributable to Starbucks	0%	10%
Earnings per share - basic	0%	0%
Earnings per share - diluted	0%	0%
Weighted average shares outstanding:		
Basic		
Diluted		
Cash dividends declared per share	0%	0%

Common Size Balance Sheet

	Sep 29 2013	Sep 30 2012
Current assets:		
Cash and cash equivalents	22%	14%
Short-term investments	6%	10%
Accounts receivable, net	5%	6%
Inventories	10%	15%
Prepaid expenses and other current asse	2%	2%
Deferred income taxes, net	2%	3%
Total current assets	48%	51%
Long-term investments	1%	1%
Equity and cost investments	4%	6%
Property, plant and equipment, net	28%	32%
Deferred income taxes, net	8%	1%
Other assets	2%	2%
Other intangible assets	2%	2%
Goodwill	7%	5%
TOTAL ASSETS	100%	100%
Current liabilities:		
Accounts payable	4%	5%
Accrued litigation charge	24%	0%
Accrued liabilities	11%	14%
Insurance reserves	2%	2%
Deferred revenue	6%	6%
Total current liabilities	47%	27%
Long-term debt	11%	7%
Other long-term liabilities	3%	4%
Total liabilities	61%	38%
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%	0%
Additional paid-in capital	2%	0%
Retained earnings	36%	61%
Accumulated other comprehensive income	1%	0%
Total shareholders' equity	39%	62%
Noncontrolling interests	0%	0%
Total equity	39%	62%
TOTAL LIABILITIES AND EQUITY	100%	100%

Part G

i. The accounting equation holds true for Starbucks as seen below:

Assets = 11,516.7 million USD

Liabilities + Equity = (7,034.4 + 4,482.3) = 11,516.7 million USD

ii. Starbucks' major classes of assets are property, plant, and equipment; cash and cash equivalents; and inventories. The proportion of short-term (current) assets to long-

term assets is 5,471 to 6,045 for a ratio of about 0.91. This ratio is reasonable in light of the nature of Starbucks as a company. As a well-established company with thousands of stores, it is unsurprising their PPE and long-term assets are high in value, but Starbucks is also a retailing company with a quick inventory turnover and a cash basis for the majority of its transactions. Therefore, it's also to be expected that Starbucks would possess a great deal of cash and inventory at any given time. The ratio of 0.91 suggests that both of these facts result in a near balance of short and long-term assets.

iii. Intangible assets are properties that lack physical substance. Unlike tangible assets like land, buildings, and machinery, intangible assets don't derive their value from a physical materiality. Goodwill is a form of intangible asset that is derived from the acquisition of a brand with future probable value. Goodwill is possessed when the market positioning of a brand, in accordance with factors such as consumer perception, provides real economic benefit. Starbucks as a company likely possesses a great deal of intangible assets in the form of trademark brand names, patents, franchise rights, and more.

iv. Starbucks is financed using a mixture of debt and equity. Equity is acquired in the form of the issuance of common stock, while liabilities are held in the form of transactions completed on credit as well as the issuance of long-term debt. In 2013, a large portion of Starbucks' debt was nested in its accrued litigation charges. The magnitude of the litigation liabilities also resulted in a sizable shift of Starbucks' debt-to-equity ratio, which was 0.61 in 2012 but 1.57 in 2013.

Part H

i. Starbucks recognizes revenues from sales to customers at the point of payment using a cash basis. When customers place orders and pay at the register within the store,

this payment (whether cash or card) is considered revenues upon being tendered. Additionally, revenues are handled distinctly with licensed stores by recognizing revenues upon the shipment of goods. Stored value cards are treated as yet-to-be received revenues; that is, revenue is not recognized upon the sale of the gift card. Rather, revenue is recognized upon redemption of the balance of a gift card. In certain instances, the balance of a gift card may be automatically recognized by Starbucks if the balance is determined to be only remotely likely to be redeemed. This treatment requires significant judgement on the part of management as they must determine what period of inactivity, based on a measured analysis of historical consumer behaviors, constitutes a gift card as being significantly unlikely to be redeemed.

ii. Starbucks' major expenses are the costs of goods sold, store operating expenses, depreciation and amortization of capitalized assets, general and administrative expenses, and charges arising from litigation. The costs of products sold and prepared as well as the wages paid to employees working in Starbucks stores are the largest cost drivers.

iii. Starbucks' reported expenses stayed in proportion between years with the exception of a new litigation charge. Starbucks experienced a massive legal settlement in that year that resulted in a cost not seen in previous years.

iv. Starbucks didn't include the expense in general & administrative expense because of its materiality and nature. To not disclose it separately would have failed to transparently communicate its significance to shareholders and to accurately depict the financial positioning of the company going forward. Further, the legal dispute itself was related to operations rather than management, and an argument could subsequently be made that a classification as an operating expense would be more appropriate.

v. In the strictest sense, Starbucks was not a profitable entity as the corporation technically failed to generate a net profit for the fiscal year. However, this figure is a reflection of the massive legal settlement it faced, and for shareholders going forward, Starbucks should be considered a company with a confident capability to generate profits through its operations. This reality is reflected in the 2012 financial statements, where Starbucks was able to generate a healthy profit in its operations.

Part I

i. Despite experiencing a loss for the 2013 fiscal year, Starbucks experienced an increase in their cash account. This is a result of the fact that Starbucks was profitable in their store operations not including the litigation charges. Although the legal settlement impacted 2013's income statement, as it was recognized upon dispute resolution, this does not indicate that Starbucks completed the transfer of cash in year 2013. They likely will continue to pay the settlement in the coming years, which allows for a sizable cash flow from operations while experiencing a loss. Additionally, noncash expenses such as depreciation and amortization of capitalized assets result in a reduction of income while leaving cash flows unaffected.

ii. During 2013, Starbucks spent approximately 1,151 million in USD cash to acquire property, plant, & equipment.

iii. In 2013, Starbucks paid out approximately 629 million USD in the form of cash dividends, while their income statement states they declares approximately 667 million USD in dividends. The difference arises as a result of the time difference in declaration and payment. A company declares dividends often several days before paying them, which in the case of Starbucks, results in some of 2012's declared dividends likely being

paid in 2013 and some of 2013's dividends definitely being paid in the next fiscal year as well.

Part J

The use of estimation is persistent throughout most financial statements. In the case of Starbucks' balance sheet, several accounts are calculated in part with estimates. Cash equivalents could perhaps be based in estimation, dependent upon the nature of the holdings. Short-term investments are likely estimated as their value can fluctuate moment by moment. Accounts receivable is estimated when reported as net due to the judgement required in projecting accounts unable to be collected. PPE is inherently estimated based on the conceptuality of depreciation and useful life. Intangibles, including goodwill, are estimated from their very inceptions. Insurance reserves are established based on a variety of factors estimating risk. Accrued liabilities might be estimated if the company accrues charges like variable utilities before receiving bills.

As established, most accounts rely upon some extent of estimation; however, some accounts are based strictly on historical cost and are free from the impact of estimation, such as common stock measured at historical issuance cost and retained earnings measured at precise profit generation.

BP

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Executive Summary

This case study took a look into the nature and treatment of contingent liabilities, including the factors that must be present for a company to record a contingent liability. An examination of accounting principles was also used to contrast GAAP-approved contingent liabilities with disallowed contingent assets. The various common contingent liabilities were listed and compared for displaying how the rationale behind contingent liabilities can result in a range of transactions being recorded. Ultimately, the relative likelihood of an event occurring as well as the feasibility of estimating associated costs to a reasonable extent prove to be central to handling contingent liabilities. Issues of judgement on the part of management were analyzed as these subjective issues must be guided by accounting principles and measured consideration.

The BP oil spill was examined through this lens as well, as a variety of liabilities arose (and continue to arise) from the catastrophe. The costs of this particular incident differ from the typical liability, such as a product warranty liability, due to the unforeseen nature of the incident. Still, after the incident occurs, BP must determine how they accurately represent their financial standing with knowledge that a variety of legal expenses will be incurred in the coming years. Historical patterns and legal environments are crucial in developing an accurate estimation of the costs stemming from the oil spill. Finally, we took a look into the legal landscape as it relates to litigation pertaining to the oil spill. BP has a legal and ethical responsibility in compensating those financially affected by their business negligence, but the extent to which companies are liable for far-reaching implications of their negligence is a determination still unfolding.

Part A

A contingent liability is a potential liability that might occur in the future of a company's operations based on current facts and circumstances. A company should record contingent liabilities when they've determined significant likelihood that the contingent event will occur in the future, and the cost of the liability can be reasonably estimated. Common contingent liabilities include product and service warranties as well as legal expenses that will be paid out in lawsuits with a reasonable likelihood of resulting in payment. The principles of full disclosure, materiality, and prudence guide the decision to record these liabilities; if a company knows that a liability will likely arise from current operations, it is their duty to accurately represent this information and reflect it in their balance sheet through a contingent liability.

Conversely, due to the accounting principle of conservatism, companies are generally disallowed from recording contingent gains. Utilizing a contingent asset account would present too many opportunities for misrepresentation.

Part B

As the purchaser of the product, BP would view the product warranty as a component of the asset that adds value, but the amount wouldn't be recorded as a distinct account unless BP were paying separately for an extended warranty. Rather, the product warranty's cost is simply incorporated into the product.

As the seller and guarantor of the product, GE Oil and Gas will recorded product warranties as a contingent liability based on the expected rate and cost of repairs. The warranty is the future amount they expect to incur in costs of maintaining the product based on current sales.

Part C

The judgements required on the part of management are related to determining when a contingent liability's probability has become significantly likely as well as accurately estimating the costs associated with the contingent liability. For accrued warranties in particular, management needs to analyze past sales and product maintenance records to determine the rate at which sold products will return for servicing. Further, the average costs of servicing the product and its parts will need to be determined to compound the value that should be recorded for a contingent product warranty liability.

A claim arising from an oil spill differs greatly in nature from product warranty claims. Product warranty claims are foreseeable, routine, and to a certain extent, unavoidable. For example, a manufacturer selling telescopic joint does so with the knowledge that some portion of the units will require servicing due to issues like defective parts. The claims stemming from a wide-scale oil spill, on the other hand, were likely unable to be foreseen on the part of BP, and BP likely does not operate their oil transportation with anticipation of a catastrophe such as the Deepwater oil spill. Still, once the event occurred, BP must look to a variety of historical and legal factors for contextualization in estimating the costs they will likely incur in coming years as a result of damages caused by their operations.

Part D

A variety of expenses are likely to be realized in coming years for BP's role in the Deepwater oil spill. The catastrophe had a far-reaching impact on communities in proximity to the Gulf of Mexico, and a range of industries were detrimentally affected by

the oil spill. Courts have found that BP was primarily responsible for the oil spill due to the company's gross negligence and deliberate misconduct. In response to looming onslaught of financial claims, BP publicly announced shortly after the incident that they would be setting aside $20 billion to settle claims. Fishing and marine farming industries suffered devastating losses in the aftermath of the incident, and many companies located within the affected area continue to lose wages or have perhaps even gone bankrupt due to their business no longer being sustainable. Additionally, the oil spill was a great detriment to tourism along the Gulf Coast as beaches and other aquatic territories became inhospitable and saw drastic decreases in tourism traffic. By extension, companies operating in the hospitality industry, such as hotels and restaurants, in these areas saw dramatic losses in revenues. The extent to which BP will be found financially responsible for these losses continues to be discovered based on court rulings and shifts in legal environments. Based on historical incidents such as the Exxon Valdez spill, payouts from the Deepwater Horizon spill will continue to be determined and made for decades to come. Ultimately, BP will have to make estimates regarding how much compensation they'll be forced to provide to these various industries in legal settlements and rulings.

From a business ethics perspective, the reach to which BP is responsible is a gray area with a range of reasonable conclusions that could be reached through competent and fair judgements. It is almost inarguable that BP should be responsible for compensating those who directly relied upon the body of water for their livelihood. For example, fishermen and harvesters of shrimp and oysters used the aquatic terrain to generate the entirety of their income, and they had equal rights to accessing the waters as BP did. BP polluted these waters due to their negligence and misconduct, and as a result, BP should

be forced to provide recovery of lost compensation for these individuals. Further, it is also certain that BP faces the moral obligation of cleaning up the spill they've made and restoring the stability of the ecosystem; various wildlife was decimated due to the introduction of toxic oil, and BP must work to remedy the damage from an ethical standpoint. The conversation becomes a bit grayer once approaching companies that were indirectly affected by the oil spill. Tourist-based industries such as hotels and restaurants saw significant declines in traffic and revenues, and subsequently they could have a good case for claiming financial compensation. However, the economic feasibility of every individual owner of rental property in the area making a claim could prove difficult, especially when establishing a fair radius for directly causation. Otherwise, the door is opened to extraneous and frivolous claims. Similarly, tourist-based companies likely have a fair claim to compensation, but what about companies that aren't tourist-based yet located in a tourist hotspot? For example, should a Walmart in Orange Beach be able to claim compensation if the store's traffic declined? Ultimately, the courts will be forced to continue to sift through these issues in a measured manner with consideration to nuance. Going forward, one would hope that the legal consequences of the spill will overwhelmingly discourage future misconduct and negligence, as the costs imposed upon the environment and a wide range of industries has proven to be astronomical.

Wendy’s

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10 April 2019

Executive Summary

When a company makes significant investments in a subsidiary company, special considerations must be made for developing a methodology that fairly represents the ability to exert material control over strategy as well as accurately portrays the value of the investment to the investing company. The GAAP sanctioned equity method is the approach currently used in financial reporting in the United States today. This case study examined the application of this accounting technique through the example of Wendy's investment in TimWen, a joint venture in form, but an equity investment in substance.

The equity method is marked by several key distinctions when compared to the fair value method used for investments of lesser scale or consolidated financial reporting used when a company owns a majority of a subsidiary. After contextualizing the scenario with background on why firms may enter into joint ventures or make equity investments, we looked at how income and dividends are reported under the equity method. While the fair value method is only concerned with the current market value of the investment, the equity method instead focuses on adjusting the acquisition cost with a proportion of income reported by investee; similarly, cash dividends received from the investee company reduce the value of the equity investment on the parent company's books. This treatment is more appropriate for instances where a company is able to exert significant influence over the business strategy of the investee. Finally, we looked at how the circumstances arising from the equity method influence the preparation of the parent's financial statements; for example, the statement of cash flows prepared with the. Indirect method must consider the nature of equity method journal entries. Ultimately, this case gave us a greater understanding of a variety of issues relating to the equity method.

Part A

There are a variety of circumstances that may encourage companies to enter into joint ventures, all of which ultimately point to greater profitability for the companies' futures. First, firms may choose to partner together for the sake of reaching new markets, especially if one firm has access to a market which the other desires to reach, or if the joint venture is able to target an emerging market. Secondly, firms may be able to achieve economies of scale in comingling resources. Thirdly, firms who are intending to launch new projects may be able to share risks and costs by joining efforts. Lastly, firms may be in possession of skills or technology, perhaps even proprietary assets, that are of great value when used in conjunction with other companies' capabilities and strategies.

Part B

The equity method is an approach to accounting for investments in associate companies, consistent with U.S. GAAP. The treatment is generally appropriate for instances in which a parent company possesses a significant amount of equity (20-50%) and subsequently is able to exert material influence in a separate company. Otherwise, the company may be able to treat the investment as though it were available for sale or held for trading at fair market value. However, the capacity to exert significant influence recalls for an accounting treatment that reflects the company's involvement in management.

Under this accounting method, the investment is recorded as an asset on its balance sheet with the initial investment being valued at the cost of acquisition. When the subsidiary company reports net income, the parent's share of income, in proportion to its ownership, should be reported as an increase in the value of the asset account. Likewise,

a share of net loss decreases the value of the asset on the books, and the receipt of dividend payments decreases the asset account (while resulting in a dollar for dollar increase in the parent’s cash account).

Part C

When an investing company pays a higher purchase price than the book value of the share of the investee’s equity, the resulting difference should be allocated to a combination of accounts. First, assets and liabilities should be written up to their fair value from the book value at acquisition as the premium on acquisition allows. Beyond this, excess payment can be recorded as an intangible asset in the form of goodwill under the equity method.

Part D

For 2011, Wendy’s reported an equity investment in the amount of $119,271,000, and in 2012, the company reported an equity investment balance of $111,533,000. On the consolidated balance sheet, Wendy’s investments in other companies are reported in a consolidated sum as “Investments” at the bottom of the assets section.

Part E

The discrepancy arises from contrasting valuation methods. While a 50% share of TimWen’s equity is shown to be $35,283 (calculated as half of net assets reported on TimWen’s separate balance sheets), Wendy’s records the value of their investment at $89,370 in 2012 resulting in an excess of $54,087. The distinction results from purchase price adjustments from the date of the acquisition and related adjustment transactions, taking place when Wendy’s receives their share of TimWen’s income – this adjustment increases the value of the equity investment on Wendy’s books under the equity method.

Part F

i) Wendy's equity method investment in TimWen positively affected Wendy's EBT as they were able to consolidate their share of TimWen's operating income in their balance sheet. In 2011, the amount earned, $13,505, was consolidated with the line entry for "Other operating expenses (net)" and allowed for an alleviation of expenses. Similarly, in 2012 Wendy's was able to report $13,680 in income, derived from their equity investment in TimWen.

ii) The journal entry to record Wendy's share of income follows:

Equity Investment	13,680	
Equity Income		13,680

iii) According to the footnotes, purchase price adjustments are being amortized based on an aggregated average useful life of 21 years. Consequently, $3,129 of purchase price adjustments was amortized in 2012, resulting in the following journal entry:

Equity Income	3,129	
Equity Investment		3,129

iv) Dividends received from TimWen are recorded as "Distributions received," and Wendy's received dividends of $14,942 & $15,274 in 2011 and 2012, respectively. The 2012 receipt is recorded with a journal entry as follows:

Cash	3,129	
Equity Investment		3,129

Part G

i) Because the company is utilizing the equity method, it recognizes the share of the investee company's net income as an increase in their own income. However, there is no cash receipt associated with this transaction; rather, income results in an increase in the "equity investment" asset account. Therefore, when calculating the amount of cash received by the parent company, the value of income derived from any increases in values of equity investments must be deducted from net income to properly arrive at the correct cash flow balance.

ii) Under the equity method, dividends received only impacts two balance sheet accounts – a debit to cash and a credit to equity investment. Therefore, cash flows increase for the investing company while net income remains unaffected. In order to arrive at the correct value for cash flows, the balance of dividends received must be added back into the parent company's net income.

Johnson & Johnson

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17 April 2019

Executive Summary

This case examined the various accounting issues related to the treatment of projected benefit obligations and retirement plans. Initially, the case required us to provide a broad view of how retirement plans are structured from a business perspective and where they're recorded on the company's balance sheet. Later, we sought to explore the various components that feed into calculating a projected benefit obligation and adjusting it according to various transactions. Similarly, the pension expense is affected by a variety of activities, and we consequently drew a contrast in the treatment of these two accounts in their handling of the "return on plan assets"; while the pension expense relies upon an expected return, the plan assets account utilizes the actual return. We discussed the rationale behind this distinction and how it may allow companies and investors to operate with short-term certainty while allowing long-term market returns to converge with expectations and negate any discrepancies.

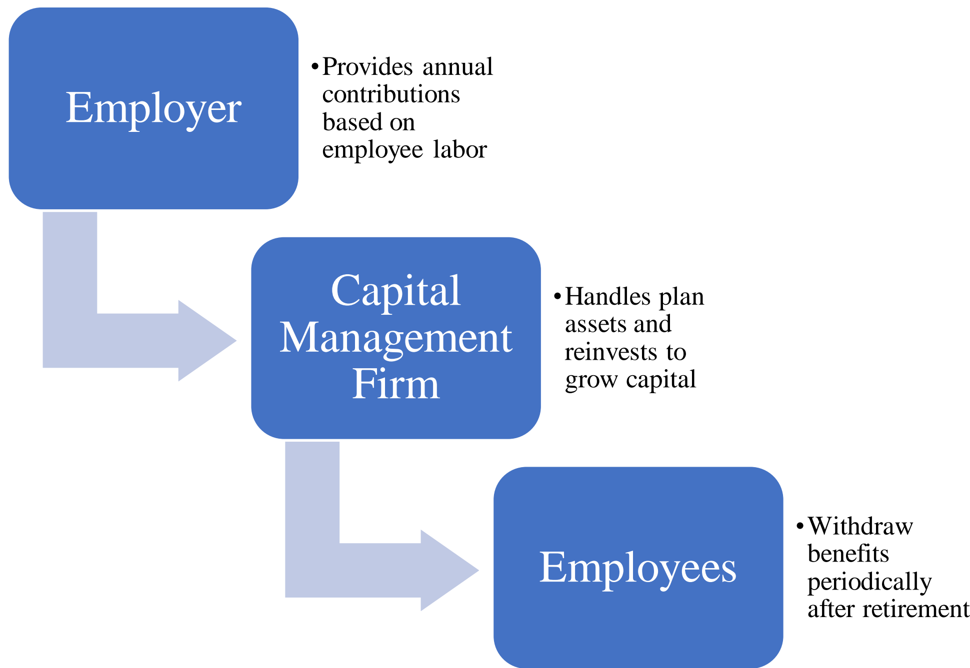
Further, we dove into the business activities taking place as the company contributes capital to the intermediary management firm and associated transactions that may be recorded as the firm handles reinvestment and remits payments to retirees. We also looked at how a company's financial statements can reflect insights into the year-to-year progression of the PBO, including the status of being underfunded or overfunded. Ultimately, this case strengthened our understanding of how a company properly handles a projected benefit obligation over the course of time and provided a specific example in Johnson & Johnson that allowed us to contextualize the various pension-related entries we've made in studying accounting theory.

Part A

i. A defined benefit plan ensures that a retired employee will continue to receive payments of a fixed amount after retirement. A defined contribution plan ensures that a fixed amount of capital will be allocated to an employee's retirement account throughout the duration of their employment, often matching employee contributions, and retirees will then withdraw benefits from the sum of the contributed amounts. According to page 60 of Johnson & Johnson's 2007 Annual Report, the company offers both defined contribution and defined benefit plans.

ii. A retirement plan obligation is a financial liability because it is a future economic sacrifice required on the part of the entity due to economic benefits they are enjoying in present periods. As they utilize the labor and services of their employees, they are deriving benefits in the present, and a portion of the contract between the company and employees is the requirement of future payments upon retirements. In future years, the company will be legally obligated to make these payments to retirees in exchange for work being done today. Therefore, companies entering into

retirement plan obligations should record liabilities on their books.



iii. The rate of return on the plan assets must be assumed based on market conditions and investment risk, and assumptions must be made by an actuary to project the life expectancy of the employee after retirement. These assumptions are critical in completing calculations.

Part B

Service cost refers to the expenses incurred by the company in establishing or furthering the projected benefit obligation on an ongoing basis as they continue to enjoy the benefit of employee services. New funds are contributed in response to this labor, resulting in service costs. Interest costs similarly increase the amount of the projected benefit obligation as the plan often requires the employer to accumulate a set rate of interest on the capital set aside on behalf of the employee**.** Actuarial gains and losses refer to adjustments in the value of the projected benefit obligation based on shifting projections of the future costs that will be incurred in paying retirees based on data projections such

as lengthening life expectancy. Benefits paid to retirees result in a reduction in projected benefit obligation as they are the fulfillment of the anticipated liability; as retirees receive their payments, the company has completed a portion of the projected benefit obligation and may reduce the value of the liability on the books accordingly.

Part C

Actual return on pension investments refers to the gains on capital invested by the intermediary managing the funds that have been previously set aside by the company to fulfill the projected benefit obligation. As this money is reinvested by the management firm, actual return on pension investments refers to the growth in the fund from investment. Company contributions to the plan refer to newly invested amounts that the company pays into the fund in response to further services provided by employees. Benefits paid to retirees, in contrast to the previous two categories, reduce plan assets as funds are remitted to individuals who have retired from the company and are now obtaining retirement payments per the terms of the plan.

Part D

The "return on plan assets" will essentially always appear with a different value depending on whether it is being reported under the pension expense component or the plan asset component of financial statements, as the company uses two separate bases for reporting this figure. Pension expense relies upon the firm's expected rate of return on its plan assets, as this allows the company to operate with stability and develop projections earlier, hypothetically allowing investors and analysts to work with a more static environment. However, plan assets need to be reported with actual return on invested plan assets, as this figure needs to be precise year to year. This account can have some

variance in overfunding or underfunding as long as the company manages its capital in such a way that it will be able to fulfill its obligation in future years.

Part F

i. Johnson & Johnson reported $646 million in pension expense for 2007.

ii.

Pension Expense	646,000,000	
PBO		646,000,000

Part G

i. The value of the PBO at December 31, 2007 is recorded at $12,002 million. This number represents the expected value of future payments that will have to be remitted to retirees per the terms of Johnson & Johnson's retirement plans. The number should be understood to be fairly reliable, although limitations exist in creating accurate estimations for life expectancy of retirees and other variables. However, growing data capabilities have allowed actuaries to develop increasingly reliable projections in recent years.

ii. The pension related interest cost for the year is $656 million, resulting in 5.62% for an interest cost. This value seems reasonable as it compares closely to the domestic cost of capital of 6.5% and the international average cost of capital of about 5.5%.

iii. $481 million in pension benefits were paid to Johnson & Johnson retirees in 2007. The company didn't directly pay cash to these retirees; instead, Johnson & Johnson had previously paid cash to a firm managing the plan assets, and the intermediary would be in charge of remitting payment to the retirees.

These payments reduce the plan assets as capital is withdrawn, but they also reduce the PBO as a portion of the company's liability is fulfilled.

Part H

i. The value of Johnson & Johnson's plan assets at the end of 2007 is $10,469 million. This represents the fair value of capital that has been set aside by the firm to fulfill the PBO, both in the form of contributed capital and gains through reinvestment.

ii. In 2006, the company expected a return on plan assets of $701 million but actually received $966 million, resulting in an excess of $265 million. In 2007, the company expected a return of $809, but only received $743, resulting in a deficit of $66 million. The expected values are probably best understood as a reflection of the economics behind the pension expense, as these figures are based on a long-term projection of the cost of capital and are less easily influenced by market condition and other short-term anomalies. Overtime, if the expected return is calculated in a sound manner, the actual return should converge with expected figures; therefore, the expected rate can be used for annual stability.

iii. In 2007, employees contributed $62 million, which exceeded the amount of $47 million contributed by employees in 2006. Additionally, the company contributed $317 million, exceeding its 2006 contributions of $259 million.

iv. Johnson and Johnson's plan assets for U.S retirement plans are composed entirely of equity and debt securities. Additionally, international retirement

plans for the company include a small amount of real estate and other investments.

Part I

In both 2006 and 2007, the pension fund is underfunded. This fact is evidenced on page 62 of Johnson & Johnson's financial statements, where the value of the projected benefit obligation exceeds the value of plan assets by $2,122 million in 2006 and $1,533 million in 2007.

Accounting Models and Bases for Financial Reporting

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28 April 2019

Executive Summary

This case study had us read and analyze a paper published by a group of researchers at the Center for Excellence in Accounting and Security Analysis entitled "On the Balance Sheet-Based Model of Financial Reporting." The paper looked into the current state of the FASB framework, specifically its underlying assumptions and focus on the prioritization of the balance sheet. The authors examined the origins and progressions of contrasting schools of thought and how the current balance sheet focus eventually won out into today's codification. Beyond this, the authors lay out a comprehensive critique of the current approach's shortcomings for a variety of reasons that we scrutinized, ranging from difficulties in application to conceptual pitfalls.

In conjunction with the critique, the authors lay out a proposal for an improvement and advocate for the benefits that will arise for all parties involved, but primarily outside investors. Ultimately, the income statement-based approach seeks to refocus on critical components of financial reporting such as the revenue matching principle. Ultimately, the authors develop a persuasive argument for how a transition to a prioritization of earnings will better align with economic and accountancy concepts.

After a discussion of the ideas presented in the paper, we looked at how the concepts shifted our perspectives held from our undergraduate course work thus far. Reading a piece that challenged the current FASB framework, rather than merely learning it as it is, was a valuable experience that forced us to think from a newly critical perspective. Lastly, we examined the implications that this conversation holds for our future careers and how the principles explored within the paper may guide our future professional mentalities. Overall, this case study was unique and valuable in its equipping

for higher-level examinations of accountancy principles and its prod towards preparation for real-life professional challenges.

Part I

Financial accounting and reporting in its modern day use primarily relies upon the assumptions and principles of a balance sheet model; that is, the balance sheet serves as the ultimate goal of accounting methodology and the primary indicator of companies' financial livelihoods. However, this is a rather recent emphasis in accountancy. The article provides context for these developments and suggests that prior to the last thirty years, there was significant ongoing tension between two schools of thought. One mindset centered itself on the income statement and argued that the accurate preparation and representation of expenses and matched revenues should serve as the chief goal, while the other emphasized the balance sheet.

Over the course of the mid twentieth century, the tension between these two ways of thinking proved difficult to maintain, and within the 1970's accounting standards gave way to the current prioritization of the balance sheet. At the time, the dominant argument was that a company's earnings should be primarily framed as its change in value, and subsequently, a change in value can't be assessed until the company's valuation itself is solidified in its balance sheet. In the following years, FASB ran with this approach and continuously ingrained it into progressing series of codification, consequently imputing accounting procedures for accounting governance outside the U.S. One logical extension of this viewpoint is the continuous reclassification of assets towards "fair value" methodology, which has proved potentially troublesome in management and application.

After laying this framework, the article then delves into points of critique for the current balance sheet-based model of financial reporting. First, the authors are critical of the prevalent mindset towards assets; by emphasizing the balance sheet, the authors argue, we fail to properly view assets as merely a temporary vehicle towards the generation of revenues for most business enterprises rather than a primary object of interest. On a larger scale, the balance sheet method therefore fails to highlight the primary ways in which businesses operate and produce income; ventures are almost always centered around the advancement of revenue against the use of expenditures, and acquisition of assets is only a channel through which this is accomplished. As a result, the examination of assets should be relegated to a secondary concern behind the consideration of proper presentation of earnings. To represent this reality, the authors invoke the approach utilized by companies' managements in the development of pro forma income statements. The logical progression on display is that companies are first and foremost concerned with their earnings, and assets will only be acquired in attempts to support projections; therefore, accounting should mirror this process.

Second, the paper argues that the focusing on assets falls short in a sense of denotation because of assets' primary reliance on earnings for their nature of identity. As assets are defined in accounting as some possession bringing "probable future benefits," benefits must be referring to earnings, and therefore even assets are hinged upon the idea of earnings. Therefore, why should FASB establish this roundabout mentality when they could instead simply begin with conversation with the production of earnings itself? In this same vein, assets can be hard to define, especially with the ever-progressing and shape-shifting natures of many businesses today. The authors invoke Microsoft to

establish the difficulties encountered in attempting to pinpoint the nature and value of identifiable assets.

Third, the authors attribute volatility and shortcomings in investment decisions to the shifting reliance upon short-sighted balance sheet computations. The authors argue that earnings should serve as the primary indicator of health in a company's finances, with robust income being a good predictor for persistent future earnings. Balance sheets, on the other hand, fail to tell a story going forward; rather, they capture a moment in time but often fall short of displaying the trend line. The authors argue that the balance sheet-based philosophy has already done significant damage to investment capacities, and should the approach go unchecked in coming decades, will likely continue to maintain an insidious presence that undermines prudency and profitability. Lastly, the paper concludes its critique of the current model with a discussion of the difficulties encountered in attempting to apply the codification accompanying the balance sheet-based model. For example, increasing shifts towards the utilization of "fair value" present a variety of issues, namely in determining a stable and truly representative market value for a range of assets. The inclination towards fair value invites market sentiments into the equation, while accountancy should strive towards measuring real economic value. Should this methodology continue developing, the issues found with dependence on fair market values will likely grow exponentially.

The authors then go on to suggest a more preferable method of approaching financial reporting, primarily with the interests of outside investors in mind. This improvement is the income statement-based model, which seeks to recalibrate the focus onto a company's earnings. Emphasized within this framework is a distinction between a

company’s financing and operating activities. Financing activities, as defined within the paper, are engagements that rely upon the use of value-storing assets (primarily cash and cash equivalents) to support and enhance other activities, and generally these interactions are peripheral and limited in nature. Operating activities, on the other hand, typically rely upon non-cash assets such as property, plant, and equipment, and seek to further the company’s business interactions through the development and proliferation of value. The authors argue that this is a valuable bifurcation which should make an appearance on all of a company’s financials, as the predictive value of these activities varies greatly with their natures. Primarily, financial activities experience greater temporal fluctuation and often correspond with economic environments and marketplace climates. Operating activities, while sure to be affected by external factors, are often more indicative of a company’s core essence and purpose, and subsequently, a more valuable predictor of future earnings behavior.

Another major feature of the proposed novel framework is the renewed focus on revenue matching principles. The authors argue that the relationship between revenues and expenses is chiefly important to a business’s financial health, and likewise, to investors and analysts. Elevating the income statement rededicates attention to this dynamic and serves to alleviate the ills seen in fixation on balance sheets. In the eyes of the authors, a renewed emphasis on matching would be the reinstatement of a recently absent “cornerstone of financial reporting.” The paper concludes with an acknowledgment of the difficulties and costs that will surely be encountered in attempting to transition and recodify, but ultimately argues that the costs of failing to

course-correct will be far higher if this conversation isn't engaged and followed with action.

Part II

This paper was engaging and provided a new perspective as an undergraduate in accounting course work. Up until this point in my studies, I hadn't had the chance to read a challenge to FASB codification, as we've first been simply trying to learn the principles themselves. I'd rarely critically thought about some of the underlying assumptions that go into the methods we're being taught, but I thought some of the points drawn out in this article were fairly interesting. I enjoyed the distinction the authors made in examining the contrasting views of earnings; specifically, the authors invited an examination of "Hicksian income," an economic concept where income is defined solely as the change in net assets over a given period of time. The adoption of this approach logically leads to a balance sheet centered framework, but a thorough consideration of our accountancy coursework highlights the necessity for recalibration. Such significant value exists within the reconsideration of earnings outside the Hicksian framework, due to a wide range of factors such as temporal restructuring and dispositions, that a lens failing to consider ongoing natures seems short-sighted and careless.

As a finance double major, I found it to be a particularly salient point when the authors invoked companies' managements' approaches to pro forma financial statements. It seems resoundingly true that the income statement will be of chief concern, with these figures being developed and projected first, and the balance sheet will follow with secondary attention paid to it. Therefore, I found it logical and valid when the authors

questioned why accounting mindsets at the highest level don't subscribe to this same mentality.

I similarly found it to be a particularly valuable discussion when the authors engaged the broadening utilization fair market value approaches. In various classes, we've been instructed towards the classifications of particular classes of assets at market value, including complicated demarcations in treatments of different natures. Even these natures are hard to identify often times though; in a separate case study for this thesis, we tackled the difficult and nebulous question of when a company can truly claim an investment is being held-to-maturity. If we continue inviting companies to report assets at "fair value," we should be aware that we're quickly yanking open a series of doors that will present a variety of challenges in ensuring accuracy, stability, and faithful representation. This component of the current FASB approach proves the most troublesome to me; accountancy should strive towards reflecting true economic value, not market sentiments. Further, increasingly incorporating "fair value" into a firm's net asset valuation could easily build a house of cards. As market sentiments become more favorable, so does the company's equity, creating a self-propagating escalation that will surely end with a costly demise. Although this is likely an extreme scenario, I found it to be representative of true concerns found in the current framework.

Part III

With plans to enter audit accounting, much of this discussion will be central to the work I'm engaging in. Especially as I strive towards auditing capital markets, much of the trouble found in speculative balance sheet approaches could prove prominent in seeking to assure fair representation of values. Inviting "fair value" into the equation for

the variety of assets held by investment firms could prove difficult to navigate and harder to nail down in a changing landscape. In a more meta sense, I would likely be in a position where the de-escalation of self-propagating financial escalations would be riskier as I would be auditing capital markets which could face major issues and risk if this framework were to continue to evolve and invite collapse. I thought there was great value in the way the authors discussed the paramount goals of accounting: to ensure faithful representation of economic value. In an audit role, I would be pursuing this same goal. At times, there will likely be conflicts with clients who are seeking the most favorable treatment possible of their assets, and these firms will likely attempt to venture into the gray areas of FASB codification. However, the principles outlined in this paper serve as valuable reminders for the proper mentality to be maintained in the accounting profession, and these tenants will be of elevated importance in a fast-paced environment where advantageous valuation and treatment of the balance sheet will prove critical.

Thinking beyond the audit role, and on a higher level of general business management potentially later into my career, I think some of the illuminated guidelines in this paper in terms of the proper emphasis on earnings rather than balance sheet will resound valuable and truthful in the long-term. While there are obviously countless instances where management can be under pressure to force a short-term emphasis on earnings, I would agree that generally the shift from a balance sheet-based mindset towards a thoughtfulness on earnings is a better approach to business. Long-term sustainability has emerged in recent year as a lighthouse in the sea of financial decisions, and firms that have sought to promote a temporary livelihood (such as an attempt to develop a favorable balance sheet in the here and now) have certainly paid the price.

With these general business realities in mind, I thought the article tapped into some valuable pathways in approaching management and profitability.

Google

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3 May 2019

Executive Summary

This case examined non-GAAP figures and how they are often utilized by companies to convey pertinent information to investors and analysts. We began the case with background reading pulled from The CPA Journal. The article sought to define non-GAAP figures and provide instances in which companies use them, as well as offer context in the current conversation surrounding the use of these figures. While controversial in their execution, it is generally agreed that some non-GAAP figures can be appropriately deployed to communicate messages of value to potential shareholders. In the first part of the Google case study, we examined a Google financial statement which displayed a non-GAAP income calculation as well as an accompanying press release that sought to explain underwhelming earnings in the GAAP figure. We looked at a table used by Google to reconcile their non-GAAP figure with the GAAP income value, and we examined the various reasons that these adjustments can credibly be made. Ultimately, we found that in some instances, such as after restructuring and discontinuation of some operations, the non-GAAP figure can be of value to investors and analysts in making judgements and projections about a company's ongoing operations.

Similarly, we examined a chart displaying the price trend of Google's stock market value and how the market reacts to the release of earnings reports as well as company press releases. Against the NASDAQ, Google's stock performed favorably, indicative of the company's strong earnings reports. Lastly, we looked at how a Wall Street Journal article can summarize the company's release of earnings and press statements, and we examined how an underlying narrative is paralleled in stock price

behavior. Ultimately, this case was highly valuable in its capacity to reveal how companies manage financial statements apart from strictly GAAP-guided numbers. We also gained insights into how real-world financial statements, even in deviation textbook protocol, and how these elements factor into the market's valuation of a company's equity.

H Part II

Google's press release for the fourth quarter includes non-GAAP figures in the form of a separately reported amount for income due to distinctions made by the company in the nature of their earnings. Google makes an adjustment that removes the impact of stock-based compensation, effects of restructuring and related charges, and eliminates the net loss from discontinued operations. Additionally, Google makes adjustments to their income figure to remove the tax impacts of these components.

These seem like reasonable adjustments to make in developing a separately reported figure for income, as such a metric provides additionally value to analysts and investors. Specifically, adjustments for restricting and losses arising from discontinued operations are valuable as they provide a stronger basis for projecting the finances of the ongoing portion of the company. Similarly, stock-based compensation is an irregular expense that can be removed from income to reflect information of interest to investors.

Part I

i. Google's stock price history enjoyed bumps in value after the company reported earnings each quarter, exceeding expectations and displaying growth in revenues and profits.

ii. Google seemed to closely mirror the pattern in the NASDAQ trend line, although there are also moments where Google noticeably outperformed the market, specifically after posting Q1, Q3, and Q4 earnings. Performance against the NASDAQ was lackluster after posting Q2 results; it is likely that Google failed to exceed expected earnings significantly.

iii. The graph seems to suggest that the market didn't react favorably to the release of Q4 financial statements, as there is a noticeable immediate dip in the price chart upon Q4 earnings release. However, one day later, the price again begins to climb and quickly passes the previous trading value, suggesting that the press release assuaged investor's concerns and provided good justification for the Q4 financials in the eyes of analysts.

Part J

i. The Wall Street Journal article is congruent with previously discussed reactions to the Q4 financial releases as well as the market's sentiments after the press release. The article refers to how investors were able to "shrug off" disappoint bottom line results after contextualizing the results with Google's comments on stock-based compensation and adjustments to ongoing operations. This narrative provided in the article matches the behavior seen in market price.

ii. Investors are likely reacting favorably to other information explored in the article, such as the fact that the volume of ad engagements is rising. Additionally, Google seems to be integrating its ad operations into new platforms in the forms of Amazon marketplaces and other software platforms.

However, investors may be skeptical of the uncertainty found in shifting ad utilization. As the online marketplace increasingly shifts towards mobile device engagement, it remains unsure if Google will continue to dominate. Similarly, Google has reportedly declined in the amounts they're able to charge per-click. However, while both these facts should be weighed in a measurement of caution, Google continued to ultimately post strong earnings and growth figures.