Utilization of Case Studies to analyze Accounting Principles and Guidelines

Ronald Bristol

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Utilization of Case Studies to analyze Accounting Principles and Guidelines

By:
Ronald Howard Bristol III

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: Dr. Victoria Dickinson

Reader: Dr. W. Mark Wilder
ACKNOWLEDGEMENTS

I want to thank my family and my high school teachers for the care and time given to me in order to reach this point in my life. I am grateful to all my wonderful professors, especially those in the Patterson School of Accountancy and the Center for Manufacturing Excellence who gave their time to support and push me along in my journey at the University of Mississippi. These wonderful people all helped make me what I am today and I would not have been able to do it alone. I hope I have touched them all in a way that they have helped me, especially Dr. Jeremy Griffin and Dr. Victoria Dickinson, in which they went above and beyond to make sure I was growing towards success all points of my college career. To everyone at the Sally McDonnell Barksdale Honors College, I want to thank you to, as mine and many others would not have the experience we do without the time and effort you all put in behind the scenes. To everyone who has been a part of my life the last 4 years I want to say thank you, as without any of you this thesis and the work behind it would not be possible.
ABSTRACT
Ronald Howard Bristol: Utilization of Case Studies to analyze Accounting Principle and Guidelines (Under the Direction of Victoria Dickinson)

The following thesis combines topics learned throughout all the undergraduate studies with real-world case studies in order to provide a personalized insight on accounting principles and guidelines set forth by the Financial Accounting Standards Board. The thesis displays many cases, each with their own focus on certain Generally Accepted Accounting Principles and how they apply to individual entities. By delving into each in order to discern what sector of guidelines applied and how, the cases were utilized in order to grasp a wide range of issues. The thesis displays understanding of current accounting topics, financial statement analysis and breakdown, and GAAP and how it is applied to statements. The case studies were completed under the Direction of Dr. Victoria Dickinson in fulfillment of the requirements for the University of Mississippi, Sally McDonnell Barksdale Honors College, and Patterson School of Accountancy ACCY 420 in 2018-2019 academic year.
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Evaluation of Tableau

Prepared by: Ronald Bristol

9/5/18
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IV. Memo to Editor ......................................................................................................6
I. Abstract

In order to delve deeper into accounting, it is necessary to look at all areas of financial reporting, not just focus on one or two. The purpose of this Accounting 420 class is to help us discover more about accounting on our own and come to our own conclusions through fact based research. In order to do this, we will look at multiple different cases throughout the year, all of them concerning a different area of financial reporting. Each case will allow us to research and think on our own about that area. We will write our conclusions regarding each case as a report that when tied together with all the other reports, becomes our thesis. This allows all the students to digest the information they are going through and put it into a written form expressing our thoughts.

II. Introduction

In January of 2003, data visualization is changed by the founding of Tableau. Data visualization is the main purpose of this software. A lot of software has that capability but where tableau is different is that Tableau is able to be explored by coders and non-coders alike. This software makes the users such as end users and non-technical analysts able to convert their data into graphics that are easy to be understood and can help in the decision making process. Tableau also has the ability to make your decision making process more efficient by being able to save time on updates and importing new data. Tableau can go through over 1 billion lines of data in a matter of seconds. Another feature that tableau has is its 2 layered system. The presentation layer of the software is separated from the data software layer allowing the user to be able to correct or update data and have the graphics automatically change to reflect the changes in data. By being able to be comprehended by all users Tableau lessens the stress that your IT team has to face by
helping interpret the graphics to end users. Tableau ends up being a great visualization and analytical tool because of its ability to handle any size or dimension number of data sets and at the same time being able to have advanced analytics portrayed that are able to be understood by people who would not normally be able to without an analyst or programmer’s help. This all enhances the purpose of being able to show significant patterns that would have been difficult to see in numerous amounts of tabular reports and spreadsheets.

Tableau is very important in the decision making process because it is the final step before making your decision. Tableau is the presentation for of your data that you have collected in a way that makes it easier to see trends and therefore make a better business decision. Tableau can be used to test and examine complete sets of data rather than just testing samples that don’t represent the entire set as well. It can also be used to express hypothetical situations and put in hypothetical data that tests your thesis on different situations all without having to adjust the initial data entry.

III. Effective uses

3-1 Audit

Tableau would be very beneficial to have in an accounting setting. Tableau works for both tax and audit purposes to help make decisions and displaying information in an easy to see way. When it comes to audit, Tableau is very useful. Imagine you were trying to compare multiple different subunits of a business at once and their uses of revenue accounts. You would be able to show on one dashboard all the subunits and their increases in revenues at certain times. To find the area where the company is not tracking revenues correctly all you would have to do is look at the visual and see which subunit was adding all their revenue at the same time instead
of realizing revenue when it is earned. Another example of Tableau being useful in an audit would be if you were an extremely large corporation that had massive amounts of data that you were trying to look at. Tableau would make the data visualization part easier and allow the discovery of red flags in a sample of amount of time that would have occurred if you had to look at all the data in spreadsheets or in tables. This is because Tableau is better suited to large and granular data sets than legacy reporting tools. Tableau would be very effective when comparing the Cost of goods sold account of a business to the inventory account. When auditing you can use tableau to show you whether or not the sale of the inventory lines up with the addition to the cost of goods sold account. Tableau would let you to input test data to show what the correct balances should be or what the trend shows should be happening. So when you see on the visual that the data does or does not match this you can make a decision on how to act on it.

3-2 Tax

When it comes to tax accounting, Tableau also has many uses. One way to use tableau to help with taxes and making decision based of taxes is to show managers the effects of adding on a new business unit, i.e. in a merger or acquisition, how the new business would affect your taxes. Tableau would allow the managers and executives of the original company to put in data for other companies they would like to acquire and see all the different effects each one has on the taxes of their company. This is because Tableau allows all levels of user to be able to understand the visuals and manipulate the data to show separate scenarios. This way the company would be able to make the best decision on which company would best fit with theirs with its current tax situation. Another way to use tableau to help with Tax Accounting would be to use it when you are working on a multinational corporation. You could use it to compare the different tax codes of each company and their effects on similar business units. This would allow
the managers to know where to expand their business to in terms of how tax effects their business units. Tableau would also be very handy when working in an area with a lot of businesses. Tableau would allow you to be more efficient when tracking taxes paid over time by businesses. You would be able to put more data into the system so the visuals so that you would see would both encompass a larger time period and more businesses. Seeing all of this in one place would allow for better visualization of companies’ tax history, thus giving the user a more efficient way to organize and report the taxes of their area.

IV. Memo to Editor

To: Tom Brady, Future Public Accounting Partner

From: Ronald Bristol, Audit/Tax Dual intern

Date: September 4, 2018

Subject: Tableau Investment

There are not a lot of investments I like to make, especially regarding software. This new Business analytics software called Tableau has recently come to my attention. I seriously think that we should invest in Tableau for our business use. With Tableau, we would be able to connect our people’s potential with data analysis. We would be able to give everyone access to data so that data would be at the center of the decisions being made at the highest levels all the way to the lowest ones. Tableau allows the user to have different permission levels for different rows of data, thus allowing only the data we want to be seen throughout the company. With this software in place we would be able to hire less people and would have a smaller need for analysts. The reason we would be able to hire less people is that Tableau allows for massive amounts of data, billions of rows, and allows for easier analysis with the way its visually
portrayed for the user. Since we would be saving so much time by using Tableau on so many of these analytical processes that we wouldn’t need as many people because now 1 person can do more work with the more time they have. So overall our staff wages would not be as big an expense if we used Tableau since it makes the process of creating visuals and reporting tools so much more efficient and makes the data easier seen in order to make decisions, therefore increasing effectiveness. Our future is bright with Tableau. With Tableau and its capabilities, we would be able to widen our scope of engagement. Since Tableau has the ability to comprehend so many rows of data we would be able to take on more and more clients without having to increase our staff like we previously would have had to. This would especially have to do with our IT department because they would no longer have to work on creating reports for everyone else and updating the data as needed. Tableau allows for the user to change and update data and allows for everyone to create reports as best suites them to make the most of the data they have. The options for displaying data help us to grow and maintain our different business units so that we can better track what happens in each unit. The scope of our future is much wider with Tableau on our side giving us the ability to act faster and smarter than our competitors. Its ability to make data analytics more efficiently available and portraying them in a more effective way will allow our firm to grow smarter and faster. Please let me know what you think in regards to Tableau and if you have any suggestions.

Best,

Ronald Bristol
Case 2: Rocky Mountain Chocolate Factory

Preparation and Analysis of Financial Statements

Prepared by: Ronald Bristol

9/12/18
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### General Journal

**February 28, 2009 – February 28th, 2010**

<table>
<thead>
<tr>
<th>Account Title</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash and Cash Equivalents</strong></td>
<td>$3,743,092.00</td>
<td>$3,743,092.00</td>
</tr>
<tr>
<td><strong>Accounts Receivable</strong></td>
<td>$4,427,526.00</td>
<td>$4,427,526.00</td>
</tr>
<tr>
<td><strong>Notes Receivable, current</strong></td>
<td>$91,059.00</td>
<td>$91,059.00</td>
</tr>
<tr>
<td><strong>Inventories</strong></td>
<td>$3,498,283.00</td>
<td>$3,281,447.00</td>
</tr>
<tr>
<td><strong>Deferred Income Taxes</strong></td>
<td>$461,249.00</td>
<td>$461,249.00</td>
</tr>
<tr>
<td><strong>Goodwill, net</strong></td>
<td>$220,163.00</td>
<td>$220,163.00</td>
</tr>
<tr>
<td><strong>Property and Equipment, Net</strong></td>
<td>$5,881,289.00</td>
<td>$5,186,709.00</td>
</tr>
<tr>
<td><strong>Notes Receivable, less current portion</strong></td>
<td>$263,650.00</td>
<td>$263,650.00</td>
</tr>
<tr>
<td><strong>Intangible assets, net</strong></td>
<td>$1,046,944.00</td>
<td>$1,046,944.00</td>
</tr>
<tr>
<td><strong>Accounts Payable</strong></td>
<td>$877,832.00</td>
<td>$877,832.00</td>
</tr>
<tr>
<td><strong>Accrued Salaries and Wages</strong></td>
<td>$464,156.00</td>
<td>$464,156.00</td>
</tr>
<tr>
<td><strong>Other accrued expenses</strong></td>
<td>$496,328.00</td>
<td>$496,328.00</td>
</tr>
<tr>
<td><strong>Dividend Payable</strong></td>
<td>$602,694.00</td>
<td>$602,694.00</td>
</tr>
<tr>
<td><strong>Deferred Income</strong></td>
<td>$220,938.00</td>
<td>$220,938.00</td>
</tr>
<tr>
<td><strong>Deferred Income Taxes</strong></td>
<td>$894,429.00</td>
<td>$894,429.00</td>
</tr>
<tr>
<td><strong>Common Stock</strong></td>
<td>$180,808.00</td>
<td>$180,808.00</td>
</tr>
<tr>
<td><strong>Additional Paid in Capital</strong></td>
<td>$7,626,602.00</td>
<td>$7,626,602.00</td>
</tr>
<tr>
<td><strong>Retained Earnings</strong></td>
<td>$3,343,850.00</td>
<td>$3,580,077.00</td>
</tr>
<tr>
<td><strong>Sales</strong></td>
<td>$12,944,017.00</td>
<td>$(12,944,017.00)</td>
</tr>
<tr>
<td><strong>Franchise and Royalty Fees</strong></td>
<td>$5,492,531.00</td>
<td>$(5,492,531.00)</td>
</tr>
<tr>
<td><strong>Franchise costs</strong></td>
<td>$1,499,477.00</td>
<td>$(1,499,477.00)</td>
</tr>
<tr>
<td><strong>General and Administrative</strong></td>
<td>$1,782,947.00</td>
<td>$(1,756,956.00)</td>
</tr>
<tr>
<td><strong>Retail Operations</strong></td>
<td>$1,756,956.00</td>
<td>$(6,956.00)</td>
</tr>
<tr>
<td><strong>Depreciation and Amortization</strong></td>
<td>$698,580.00</td>
<td>$(698,580.00)</td>
</tr>
<tr>
<td><strong>Interest Income</strong></td>
<td>$(27,210.00)</td>
<td>$(27,210.00)</td>
</tr>
<tr>
<td><strong>Income Tax Expense</strong></td>
<td>$2,090,468.00</td>
<td>$(2,090,468.00)</td>
</tr>
</tbody>
</table>

**Total Debit:** $28,090,468.00  
**Total Credit:** $28,090,468.00

### Trial Balance

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<td>$(27,210.00)</td>
</tr>
<tr>
<td><strong>Income Tax Expense</strong></td>
<td>$2,090,468.00</td>
<td>$(2,090,468.00)</td>
</tr>
</tbody>
</table>

**Total Debit:** $28,090,468.00  
**Total Credit:** $28,090,468.00

**A = L + OE + RE - E**
**II. Income Statement**

For the year ended February 28th, 2010

<table>
<thead>
<tr>
<th>Revenues</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$ 22,944,017.00</td>
</tr>
<tr>
<td>Franchise and Royalty</td>
<td>$ 5,492,531.00</td>
</tr>
<tr>
<td>Total income</td>
<td>$ 28,436,548.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Sales</td>
<td>$ 14,910,622.00</td>
</tr>
<tr>
<td>Franchise Costs</td>
<td>$ 1,499,477.00</td>
</tr>
<tr>
<td>Sales and marketing</td>
<td>$ 1,505,431.00</td>
</tr>
<tr>
<td>General and Adminsrative</td>
<td>$ 2,422,147.00</td>
</tr>
<tr>
<td>Retail operating</td>
<td>$ 1,756,956.00</td>
</tr>
<tr>
<td>Depreciation and Amortization</td>
<td>$ 698,580.00</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>$ 22,793,213.00</td>
</tr>
</tbody>
</table>

**Operating income** $ 5,643,335.00

**Other revenues/expenses**

| Income from interest           | $ (27,210.00) |

**Income before Taxes** $ 5,616,125.00

**Income Tax Expense** $ 2,090,468.00

**Net Income** $ 3,525,657.00

---

**III. Balance Sheet**
Rocky Mountain Chocolate Company

February 28th, 2010

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$3,243,092.00</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$4,427,526.00</td>
</tr>
<tr>
<td>Notes receivable (current)</td>
<td>$91,059.00</td>
</tr>
<tr>
<td>Inventories</td>
<td>$3,281,447.00</td>
</tr>
<tr>
<td>Deferred Income Taxes</td>
<td>$461,249.00</td>
</tr>
<tr>
<td>Other (current)</td>
<td>$220,163.00</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>$11,724,536.00</td>
</tr>
</tbody>
</table>

| Property and Equipment Net |          |
| Other assets               | $5,186,709.00 |
| Notes receivable less current | $263,650.00 |
| Goodwill, Net              | $1,546,944.00 |
| Intangible assets, Net     | $110,025.00 |
| Other (long term)          | $88,050.00 |
| Total other assets         | $2,008,669.00 |
| Total Assets               | $18,919,914.00 |

| Liabilities and Stockholders Equity |          |
| Current Liabilities              |          |
| Accounts payable                 | $877,832.00 |
| Accrued salaries and wages       | $646,156.00 |
| other accrued expenses           | $946,528.00 |
| Dividend payable                 | $602,694.00 |
| Deferred Income                  | $220,938.00 |
| Total Current Liabilities        | $3,294,148.00 |

| Deferred Income Taxes | $894,429.00 |

| Stockholders Equity |          |
| Common Stock        | $180,808.00 |
| Additional Paid in Capital | $7,626,602.00 |
| Retained Earnings   | $6,923,927.00 |
| Total Stockholders Equity | $14,731,337.00 |

| Total Liabilities and Stockholders Equity | $18,919,914.00 |

IV. Cash Flows
The company purchased $7,500,000 of raw material inventory on account. “On account” means that their suppliers have not yet been paid. That is, Rocky Mountain Chocolate has an additional “Account Payable” for the inventory purchase.

Operating
During the year, the company incurred $6,000,000 of factory wages. When wages relate to the production of a company’s inventory, the wage costs are added to the inventory account. For now, assume that the wages have not yet been paid.

Operating
The company sold inventory that cost $14,000,000 for a total of $22,000,000. Of that, $17,000,000 was received in cash and $5,000,000 was on account (that is, added to accounts receivable).

Operating
The company paid $8,200,000 to suppliers for inventory it had previously purchased on account. That is, it paid $8,200,000 of accounts payable.

Operating
The company collected $4,100,000 of accounts receivable.

Operating
The company incurred sales and marketing expenses of $3,935,431, general and administrative expenses of $2,644,509, and retail operating expenses of $1,750,000. They paid $2,000,000 in cash and $3,000,000 was added to other accrued expenses.

Operating
The company paid $6,423,789 to employees for wages that had been previously accrued.

Financing
Rocky Mountain Chocolate Factory received $125,000 in cash from new franchisees. The company must provide services to the franchisees over the next five years. As such, the fees are considered deferred income.

Financing
The company paid $498,832 for new property and equipment.

Investing
During the year, the company declared $2,403,458 of dividends on its common shares. They paid $2,403,458 during the fiscal year. The difference, $3,709, will be paid in the following fiscal year.

Financing
Many other transactions were recorded during the year. They are summarized in the spreadsheet. Do not attempt to interpret individual entries as many involve offsetting debits and credits and the resulting values are not figures.

N/A
Rocky Mountain Chocolate Factory employees took a physical count of inventory on February 28, 2010. The cost of inventory in the company’s possession on that date was $3,281,447.

Operating
Depreciation and amortization expense on property and equipment was $699,380 for the fiscal year.

Operating
At year end, the company determined that $646,156 of wages were earned but remained unpaid. Of that total, $639,200 relates to general and administrative expenses, and $6,956 relates to retail operating expenses.

Operating
In February, 2010, a consulting firm hired by Rocky Mountain Chocolate Factory issued a report stating that the “Rocky Mountain Chocolate Factory” brand name is worth $500,000.

Financing

V. Balance Sheet Insight

Based on analyzing the company I would expect the following things to be occurring.

I expected to see inventories and sales accounts. I expected to see a lot of expense accounts to show all the different expenses incurred in order to get their inventory ready for sale. The major assets are going to be inventories and cash, as well as receivables and property, plant, and equipment. The major liabilities for Rocky Mountain Chocolate company are wages payable and accounts payable.

VI. Reclassifications and Adjustments

There will most likely need to be a change made to inventories because of differences in expected vs physical count at the end of the period, so we will have to make an adjusting entry to correct the amount in the inventory account. The company has property, plant, and equipment long term assets so they will have to account for depreciation and amortization. They might have
to adjust their revenue accounts to account for orders shipped out at the end of the period or for cash received from orders already shipped before the end of the period.

**VII. Summary**

In this case we looked at the transactions and balance sheet for Rocky Mountain Chocolate Factory, Inc. We used this to prepare an unadjusted trial balance, an adjusted trial balance, and post-closing entries balance. This allowed us to see how the accounts close out at the end of the period and how that affects other accounts. Retained Earnings is the end account affected by the closing entries since income summary gets credited into retained earnings. We were also able to see how a merchandiser would keep their statements and the normal adjusting entries that go with such an incorporation. The preparation of financial statements allows us to see the true insides of a company like this when it comes to the end of an accounting period.
Case 3: Decisions after accounting undergraduate

Debate amount Honors Students

Prepared by: Ronald Bristol

9/18/18
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I. Summary

In class last week, our group had a series of discussions concerning the logistics of our professional career after we go through accounting undergrad and the accounting internship process. The first discussion we had was if you should go to law school after your accounting undergraduate degree or if you should go straight into accounting. The end result in this scenario was to be doing tax law through the law firm or tax through the accounting firm.

II. Discussion

In class the majority of people sat on the side of the room that argued for going to law school, but I chose to stay on the side of staying with accounting. The discussion took off and both sides made a lot of good choices. For example, if you were concerned with the amount of money you make then going to law school will not help you as much because the starting salary is higher than if you were to just get your accounting undergraduate and work right after college. This is because after 2 years of work, the salaries between the two level out and that 2 years of work would be accomplished during the time when you would have been at law school earlier. For me this made a lot of sense because I would rather get work experience earlier and have a chance to climb the corporate ladder earlier than the law school people. Law school does have its benefits though. If you do decide to do the 2-year program, you will greatly be able to diversify your career options because you won’t just be stuck working with a business degree. If you go to law school after accounting you will still be able to do accounting work, but you are also able to tap in to all opportunities available to you within law. My personal opinion to this was if you did not know what you wanted to do when you left college then this would be a perfect plan for you because you still were securing a future by attending the Patterson school of accountancy, but just in case you did not want to work in accounting and business forever, you will have law to
also go to. I do think I would still stay with the accounting internship and not going to law school. I want to stay in business my whole life and accounting is the language of business. My undergraduate degree will prepare me for a job at an accounting firm, but it will also help me to be well versed in other ways of business also. In the end I would understand people’s decisions to go to law school but since I do not have to go to school for 2 extra years, can save on the cost of attendance, get more work experience earlier, and I know I want to stay in the business world, the accounting internship to working at an accounting firm seems to be the better path for me.

The second scenario we were presented with was a more likely scenario in my opinion for all of us in class. If you knew you wanted to work in banking/finance should you still go through the accounting major and internship or should you just switch over to one of those disciplines for your major. A lot of people tried to make the argument that you can switch positions from the scenario above because they are very similar. Another case was made for the fact that if you do this you are taking away an accounting internship for someone that wants to work in that world. To me both of those opinions just helped the side I was on more. If you think about both of these situations; going to law school is not very similar to accounting, but finance and banking is very similar. The degree you get from the school of accountancy would translate way more efficiently over to banking/finance than to a law school. Some of the points made in class were that you should worry about taking an internship because everyone has got to earn them, if you are trying to better your future situation then accounting school and the internship process that follows is a great decision for you if you plan on going into banking/finance. This is because as I said earlier accounting is the language of business and many people with accounting degrees end up working in related field such as banking, finance, and consulting. Many firms that I have had the pleasure of talking to have programs set up so while you are in your
internship process they will be able to give you a taste of the field that you do want to go into later on. This would mean that the accounting internship would be doubly helpful because it would give you a big taste of accounting and a little taste of your other business passion and let you see how much you like or don’t like it. This situation to me is different from the one above mainly because of the relatedness of the other options. I would not go into law school knowing I wanted to work in the business sector, but I would still major in accounting if I knew I wanted to eventually branch off into another business related field later on.

The last scenario to me was very different than the first 2. The first two were regarding getting to your career and the steps to get there. This scenario is concerned with your decision after you have finished your accounting internship. If you worked in DC for the winter and then came home to Dallas and decided that you would want to work there, would it be okay for you to email Dr. D about the transfer process to Dallas. I instantly sat on the side of not moving from DC to Dallas. The transfer side of the discussion said there was no issue with this and that if you wanted to move it should be reasonable that Dr. D can help you with this. My opinion was that this situation was all about transparency with your superiors in the workplace. I felt that if you had made the decision to work in DC then you should work there until you have the opportunity to move or until your such a high performer that you are able to get the transfer you want. The decisions I came to on this case were concerning my relations with my bosses, and the way I would go about handling this scenario would be as soon as I knew I wanted to be back in Dallas, I would have sat down with my boss and told him/her my exact reasons for wanting to go back. The argument I made in class was that you need to think about your career early so that you do know where you want to go for your internship so you don’t make a bad decision and cause more hassle for your employers later on. I understand confiding in Dr. D that you want to move but I
think that when you are making decisions as big as these you need to be face to face with the people that also have a say in your ability to move.

III. Lessons Learned

Navigating any industry is hard, especially the professional services industry. In order to make the most of your time you need to truly figure out what you want out of a career and ensure that you are communicating correctly the entire time. Communication is key as it allows all parties to stay on the same page. Things are changing constantly in life and this means you always need to be upfront and honest as things do change. All the planning and preparation do not allow a perfectly straight forward out life. In order to make sure you are not in the wrong or causing any parties any unnecessary pains, you need to constantly be aware of your wants and needs and how that could affect your future. The key to this is just making sure you don’t try to hide anything or try to go a round-about way in order to get what you want.
Case 4: Generic Bank

Debt Securities and Impairment

Prepared by: Ronald Bristol

10/3/18
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I. Introduction

In case 4 we examined Generic Bank and their sale of available for Sale Debt securities. We had to determine whether or not they were impaired and how that determines how and when these securities are reported on the balance sheet. Before this case I did not understand what the word impairment even meant to debt securities or what the codification said about impairment of debt securities. At the finish of this case I now understand how you classify a debt security as impaired and what the codification says about impairment. Securities are tricky to deal with and require judgment rather than just straight up rules. In each of the cases below you have to support your logic with the codification that supports that line of reasoning. That is how you judge whether or not a security is impaired. You have to look at many factors when doing this, you cannot just look at the codification and get a straight answer right away. Some of the more useful things to look at when deciding impairment are the financial position of the firm, the loss or gain on said securities being sold, and the time frame that they were sold in. One of the biggest things to look at when determining impairment and when impairment is recorded is the intent to sell. This is what greatly helped us to answer questions 1 and 2. Other parts of the codification helped me to look at securities in the correct ways. You have to look at each security on its own, and you cannot determine impairment just from the overall gross gain or loss of numerous securities. That is what makes you have to go back to intent for question 2 and question 4. This case was very useful to me in understanding the treatment of securities and the sale of securities. I now am able to understand how to determine impairment of securities and when those losses from impairment should be recorded.

II. Discussion on Impairment loss
The seven securities that were mentioned to be sold are CUSIP 003, 015, 025, 030, 067, 076, and 096. The values of these securities are all independent of each other and 5 of the 7 are in a position of net loss right now. The 5 that are in a loss position are considered to be impaired because of ASC 320. This is because ASC 320 states “a debt security is considered impaired if its fair value is less than its amortized cost basis”. There was an intent to sell which is one of the two requirements that can make a security impaired, because they sold them so close to the end of the year. They had been planning to sell them in the current year so the impairment is certain and since the intent to sell was in 20x2 then there would be an impairment on these 5 CUSIPS: 003, 015, 025, 030, and 076. Since there was an intent to sell we do not have to look at if there will be an ability to recover from the amortized cost basis. So in the end according to ASC 320-10-35-33A since “an entity does intend to sell the security, or it is more likely than not that it will be required to sell an impaired debt before recovery, an OTTI exists” and they had intent to sell the impairment loss would be recorded in 20x2.

III. Decision not to Sell

In the case above there was intent to sell those 7 securities, but in this case we cannot use that as part of our reasoning for determining impairment on the other securities. According to ASC 326-30-35-4 you have to assess impairment at the individual security level which means that we would have to look at each security to determine if it has been impaired or not. Since there was no intent to sell then according to ASC 320-10-35-33A and 35-33B we have to look at the ability of the firm to recover the debt on the security or the need to sell them later. The firm is in a good financial position and is well capitalized so they will be able to wait and see if they can
recover the losses. This means that they have no need to sell other securities so unless their
financial position changes the other securities would not be listed as impaired. ACS 325-40-35-
10A says that further analysis and judgement are required to assess whether a decline in fair
value is an indicator, so since there is no intent on 20x2 on the other securities you would
determine impairment at the end of 20x3 depending on the situation of the firm and the change
that have gone on in your amortization costs. To conclude question 2 there would be no
impairment loss on the other securities since the firm is in a good position and each security has
to be evaluated individually.

IV. Point of View for Decision Making

If a were to assume the role of Heather Herring or a bank regulator, my answer would not
change. I would not change it because the codification states how you should treat securities and
regardless of my position I would still have to look at the codification to get my answer. This
means that my overall answer would stay the same because the codification backs up what I say,
but if I was to assume their roles I would look at some separate factors that I had not previously
looked at. I would have look at significant changes in the company from prior periods and how
that effects the risks of material misstatement. If I was an external auditor, I would make sure I
understood the industry and regulatory environment surrounding specifically Generic Bank. I
would also take a look at the company objectives and see how that affects my expectations of
their future actions in determining impairment versus non impairment. Assuming the role of
either of those would make me more cynical than before because it would be part of my job to
make sure nothing benevolent was occurring.
V. Gain Position

My answer to questions 1 and 2 would not change based on the first change in scenario. As stated above, “ASC 326-30-35-4 you have to assess impairment at the individual security level which means that we would have to look at each security to determine if it has been impaired or not” which means that even though they are in a total net gain position you need to look at everything on the individual level, so as long as those 5 were still in a loss position then you would have to still record impairment on those for 20x2. That does not affect my answer to question 2 either since there was no intent to sell and the bank has no need to sell to increase the financial position of the firm. In scenario 2 the answer to question 1 changes, because every security is in a net gain position there would be no impairment loss on any security. The ones that you sold in 20x3 would still all have to be reported in 20x2 because of intent to sell, but there is no impairment loss, so it would be all an increase to your 20x2 statements. This scenario also solidifies the answer to number 2 because with no losses, you would not have to question impairment on any other security that was not sold because you cannot consider it impaired according to ACS 326-30-35-1 which states “an investment is impaired if the fair value of the investment is less than its cost” so with every security in a gain position then you would not have impairment.

VI. Loss Position

In this case, the Bank is not as well capitalized as before and they do not have the wide availability to borrow in order to meet liquidity. This means that on all securities that that have a present value less than the amortized cost basis of the security, a credit loss exists according to ACS 326-30-35-6. There would be an impairment loss on other securities because the need to
sell would rise because of the banks financial position. So all of the securities that were in 
positions of loss that were not recoverable would be listed as impaired in the year 20x2. ACS 
326-30-35-10 states that “if an entity does not intend to sell the debt security, the entity shall 
consider available evidence to assess whether it more likely than not will be required to sell the 
security before recovery of its amortized costs basis” so the other securities not sold that are in a 
loss position determined to be no recoverable before sale are considered to be impaired and they 
would be reported in 20x2.
Case 5: 2 Different Cities

Metropolitan Areas: North vs South

Prepared by: Ronald Bristol

11/7/18
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I. Summary

This case called us to look at 2 cities that we thought we were very interested in and explore them deeply. It tasked us with the ability to make a rationale based decision after making us the student go out and find all the data ourselves first hand. We looked at variables ranging from rent, travel, civic organizations, and social life all the way to taxes by location and operating budget by location. This caused us to get a full span look at our two city choices in order for us to fully understand what our decision was going to mean for our future. After comparing all the data, we had to make a decision of which city we would live in or both or neither, and for me that decision was very easy after doing all of the research.

II. Population

The population for the city of Dallas in its most recent year was 1.34 Million people according to World Population review. Compared to my home town of around 16 thousand, this is a way more population dense area than anything that I am used to. Having 1.34 Million people in the city you start your career in can seem kind of daunting, but the exciting possibilities that can be dreamt up with so many people and business in the area are enough to make any young professional want to live in the area.

In New York there is an even greater contrast to the population I live in now to what it is in the city. The total most recent population is 8.623 million which is almost 6 times more than that of Dallas’s. The population would allow for the most diverse group of people I have ever lived amongst and It would definitely be a challenge getting used to the change of scenery. I am up to both the challenges of these two cities and the large population is something I have been wanting to be a part of for a while.
III. Climate and Seasonal Fluctuations

The climate in Dallas, TX is listed as Humid Sub-tropical which means that there are some seasonal extremes in Dallas. This also means that the temperature and humidity are constantly different throughout the seasons. In the spring, Dallas is a very wet and warm. In the spring there are more storms than any other season in Dallas because of the air currents coming off of the Gulf Coast. Dallas starts its transition from Spring to Summer in terms of weather in about mid-June. This is around the time when Dallas transitions from soaked and warm to dry and hot. The summers in Dallas are just hot. Multiple days of the summer will consist of temperatures over 100 degrees Fahrenheit. On average every summer there are 18 days with heat equal or greater to than 100 degrees. Then fall is just right around the corner and as soon as early September hits the weather starts to cool off, and by the end of October the temperature average is in the 60’s, with the first day of freezing weather usually not occurring until late November. Then around early December you transition into Winter in Dallas and you have an average low of 39 degrees. Accumulation is rare in Dallas, and there will even be winter days in which it is sunny and 70 degrees outside. the differences between the seasons in Dallas can be kind of volatile, but so can they also in Mississippi. The ability to experience true differences in seasons, but also to have super beautiful falls and springs is very nice, as long as you can handle the heat in the summer.

New York is located in the upper part of the state of New York. First off, if you don’t like the cold don’t come here. The highest average temperature for the year was in June at 85 degrees. The coldest it gets throughout the year is in January and February at average low temperatures of 26 and 28 degrees respectively. One really good thing about New York is that
you get wet all year long. The Avg rainfall per month in inches stays in the range of 2-5 inches per month throughout the year. So the seasons in New York aren’t volatile in terms of humidity, but when you take into account that a lot of the rainfall turns to snow during the winter months, you have to also be able to deal with the snow. I would love to live in a place that you are able to wear pants year round, but I don’t know how I would deal with the amount of snow they get.

**IV. Topography, Scenery, Geographic features.**

Dallas as a city is what you would expect from something in Texas. The entire city lies at elevations ranging from 450 Ft to 550 ft. above sea level. You won’t be seeing to many rolling hills in Dallas, just the ups and downs of the massive buildings littered throughout the city. Dallas does have some beautiful parks and recreational areas that allow you to escape the big city streets. The area of Dallas has a surprising number of man-made lakes in the surrounding area. It would be nice to be able to take a ride in the boat after a long day in the office in the beaming heat of the Dallas summer sun.

New York is super interesting when it comes to topography and geographic features. The Harlem river separates the Manhattan from the Bronx. There also is Long island which allows for a connected web of bridges and roads that make traveling the city very hectic. The island extends out into the sound and allows for shipping and quick access to sea transportation. The scenery in New York consists of the concrete jungle. New York is more than just buildings but a lot of New York buildings are architecturally amazing so there are views to see all over the city. Along with this there are numerous parks and beach’s that you can go to when the weather is finally nice enough. I would be able to handle the changes between boroughs and land masses and the beauty of the logistics that go into New York.
V. Tax Rates

Dallas has a statewide sales tax rate of 6.2 percent, but in cities there can be a county and tax total imposed of 8.25 percent. This is the rate that is most commonly seen within the city limits of Dallas for sales tax. Dallas also has no income taxes, so the total amount of my income will be what I made. Now that doesn’t mean that Dallas does not have other taxes at higher rates to combat this. The effective property tax rate in Dallas is one that comes as a result of your individual tax rate and the value of your property. You can have different levels of property tax because there is no single state property tax, instead counties and cities come up with taxes for the residents. This does mean that I will still have to pay the federal income tax burden on the 50,000 dollars. The tax rate effective for an income of 50,000 leads to a federal tax burden of around 9075$ or an overall effective federal tax rate of 18 percent. Dallas lets the person make the money, but then Dallas also lets the person have ways to spend money. Yes, it is nice to have not state income tax, but with the higher sales tax and property taxes, Dallas is making sure they make that money back somewhere.

In New York, your income gets taxed to the max. New York city has a tax rate prescribed for people that live in the city along with the state wide income tax rate. The highest rate you can pay is 8.25 percent for income state taxes but earning at 50,000 dollars would call for a state tax rate of 6.45 percent plus an additional 2.907 percent for city income taxes. So at an income of 50,000 you would be paying taxes of $4,678.5. When it comes to property taxes you get classed based on how nice of an area that you live in. You can get taxed at least of 10.514 percent or at the most of 20.385 percent. As you can see, you pay a high rate for living in NY, but you also get paid more to work in New York. I don’t like having to see that much of my earnings go away.
especially since in either case I am making 50,000 the first year so living in New York you would need to be able to budget wise in order to live the same life you live in Dallas.

V. Transportation

Dallas has outstanding amounts of options for public transportation. In terms of traveling by car, you have access to CVB taxis, Uber or any like service. If you want to travel by bus in Dallas hop on board the DART. If public buses aren’t your thing, there is an M-Trolley downtown and you can always rent a bus or get on a greyhound. Dallas also has a rail service, the DART Dallas Mass transit rail that you can take to get almost anywhere in Dallas. If you are trying to leave or enter the city of Dallas there are multiple commercial airports and even a private airport right outside the city. Living in Dallas you can get anywhere you want to go in whatever fashion you would like, you don’t even need your own car. That sounds like an exciting and new way to live life after having to drive a decent amount in Oxford.

Living in New York you will have very little need for a car. When you research what the most used methods of transportation are for New York, helicopter comes up before personal car does. The most popular methods of transportation are Taxi, Public Bus, and Subway. New York has over 6,000 buses in their fleet that run 322 routes. If you need to get anywhere in New York one of those three options will be the fastest, most cost effective method of getting you where you need to be besides walking or biking which are free. They may not get you there on time like the previous 3 methods though. When it comes to getting in and out of the city, the ferry, airports, and railways will be able to do the job for you. JFK will be able to take you anywhere internationally that you need to go. New York understands how crowded it is, so they took the
time to make sure there would be enough transportation options available to you so that you can get anywhere you need to go.

VII. Prevalent industries

The top industries in Dallas are Defense, Financial services, and technology. I think all of those areas are growing market wise, and technology is still rapidly rising. Dallas is set up to be an industrial center of America for many years, and to work in that culture and be a part of the success Dallas is having would be super rewarding.

New York’s top industry is Financial services, as you could assume from Wall street and the existence of the NY stock exchange. The next 2 most prevalent industries right now in NY are Health care and Professional and Technical services. Being able to be a part of the Financial service sector in New York would put me at the top of a sector and in one of the most challenging sectors in America. I would love the challenge to work with the best and the brightest in New York on some of the most important American Data there is.

VIII. Healthcare

Dallas’s hospitals are constantly getting ranked in top upper echelon of Americas best hospitals. Finding adequate care is not an issue in Dallas and it is a big reason why people head to Dallas in the first place. It’s nice to know that if you ever get hurt or sick, your own back yard has some of the best in the business available to make sure you get running smoothly again. New York has great healthcare services, but they come at cost. New York has the 6th most expensive spending on personal healthcare out of all of the states. There are 13 accredited medical schools in the state of New York, so the talent at your hospitals and healthcare providers is on average higher than the majority of states also. The amount of hospitals in the state of New
York is 204 and in the city alone there are 62 acute health care hospitals. The service of healthcare in New York is worth it, you just have to be okay with spending more money in order to get it than you would in a lot of other places.

**IX. Rent**

For the first three years I would live in a more affordable housing situation a little outside of the main city of Dallas. It would cost between 1.2K a month and 2.5K a month to and the reason for the jump from 1 to 2 thousand is when you switch from 1 to 2 roommates’. The ideal income in order to afford this apartment is 47,000 $. So at my salary of 50,000 I would be $3,00 in the positive. This apartment would be around 1.0-1.2K square feet, which is more than enough room for a sleeping space; since I am a young professional trying to make my way in the world, I will be working and always in the city and so this space will be more than enough. There are 2 bedrooms two baths, with luxurious amenities, including an entertainment lounge, business center, wellness center, and resort-style swimming pool. Also in the area are multiple theaters, restaurants, and billiards venues. You can also optionally purchase a private garage to park your car if you need at 150$ a month, but transportation is available making owning a car unnecessary. The Branch is the perfect place to live as its close enough to the city to have quick commute in and far enough to not be super costly and still include a lot of things close by in the area.

When you work in New York, you want to live in New York, and the closer the better. The commute times in New York are drastic because of the density of the workforce during normal business hours in the city. One of the great spots to live in New York is in Washington Heights, Manhattan. For living in Manhattan the rent is not what you would expect. The Per bedroom average rate is 985 a month or if you choose to live in a single apartment it gets closer
to 1750 month. Washington heights has a super low crime rate and a high number of young professionals live in the area so safety wise and people wise you will be in a good place with a lot of persevering individual like yourself which is always good for continuous improvement. The commute to Midtown is 30 minutes by way of the easily accessible A, C, and 1 trains that travel all up and down Manhattan. If public transportation isn’t your thing, Washington Heights is one of the most bike able areas of New York. The Avg square ft. of an apartment is 905. Near to it are a ton of local grocers and shops, but if you need a larger superstore then this is not the place for you as the travel to those is a lot longer because you will have to drive or take public transportation. Washington Heights would be a great place to live as a recent college grad getting started in the big Apple.

X. Commute

There are 3 main ways to commute into Dallas for the work day. You can drive your car if you own one, which would take on average 5-10 minutes to get into the city. If you choose to take a bus or ride a bike, the time it takes to get into the city increases by 10 minutes on average. The bus would pick up right near where the branch is located so commute from this location would be simple and easy to use public transportation with. The majority of people do drive cars from the branch though. I would be able to choose either or and depending on the rush I am in my options my change daily.

In order to commute from Washington Heights, you will either take a train, taxi, bus, or you can bike/walk. Yes, driving is always an option, but the majority of people who live in the surrounding area use the trains in order to get to where they are trying to go. By train the commute is closer to 30 minutes. You do save on the cost of having a car so if you need to speed
up the 30-minute ride, you can opt for a taxi that, depending on the traffic, will be able to get you where you need to go in 10-15 minutes.

**XI. Grocery and Laundry**

In Dallas, within 2 miles of the apartment, there is a Trader Joes, and a Whole Foods where I could get any amount of grocery shopping done. In order for me to get my laundry done I won’t have to even leave my apartments. Part of the amenities in the apartment are a full size washer and dryer, so I will not have to pay for laundromat costs. While I do not really love the “healthier” food shopping options, I am not absurdly picky about food so I will be able to eat just fine with those 2 stores so close to me.

New York’s Washington Heights does not have the big grocery store right near it, but with the multitude of stores and shops in each little community, you won’t have to look far to get what you need. The learning curve of where to go to get specific things will be harder since it will be a new environment and style of shopping, but it allows you to be able to walk outside and get the ingredients you need for dinner within a 5-minute walk of your apartment. In terms of laundry you will have to pay to do your laundry. You have 2 options for this, and you can either go to a laundromat which is the cheaper option, but if you are on a time crunch you can purchase the pickup and delivery laundry service. But the price is higher and the risk is higher because you might not get the clothes when you need or they could misplace some of your clothes. I don’t like not being able to do laundry in house and I don’t want to have to purchases a washer/dryer just for my small apartment, it is nice that there are so many laundromats close to Washington Heights so you do not have to go that far to do laundry.
XII. Civic Engagement

One of the most interesting things about Dallas is the Dallas Entrepreneur Center and within this organization I would be able to help people learn how to network and be able to mentor someone and help them grow their idea or business into what they envision it. The habitat for humanity in Dallas is an organization I have been involved with in the past and would love to continue to be involved with them. The habitat for humanity is a great organization that helps out people in the area with almost any need, whether it is home building, food collection, clothes drives, habitat for humanity is bettering each community it comes into and since it’s in Dallas, it will be an organization I would definitely become involved with. Being a Catholic, I would regular attend church at my local catholic church, which is 8 minutes from my apartment by car, I would also become involved in community activities put on by the church in order to spread awareness or help the community. The current population of Dallas is only 13 percent catholic, so this would be one of the smaller organizations I would becoming a part of.

Being so diverse and so populated, New York has an unbelievable amount of organizations to be a part of and to find something that fits just for you. One of the things that is super important to me is the sport of soccer, and New York has a nonprofit organization called 06 United Football club, and the aim of the organization is to help develop children within the ages of 5-15 mentally and physically to be better on and off the field. I would love to be able to spend time with the youth in the community and play a sport I love and pass on my knowledge to those younger than me. New York also has an organization called Top Honors, which focuses on teaching middle school aged children math fundamentals and providing real world examples in order to ensure that the concepts stick with kids over the rest of their life. I think math is fundamental to a person’s growth and ability to succeed in this increasingly data driven world,
and to be able to help my community grow stronger through Top Honors would be something definitely interesting if I were to work in New York. I would like to help give back to people other than the youth, so another organization that helps out the community that I feel a strong pull to is Stanley M Isaacs Neighborhood center which helps people of low income and the elderly to help provide and support for the needs of people who cannot do it on their own.

XIII. Recreation

Dallas is a city alive with sports. You can like college sports, high school sports, or professional sports. They have it all. You have one of the most popular brands in American football. If you like college sports, SMU has men’s and women’s NCAA teams if you want to go watch any sport that pleases you. The NBA has a team in Dallas also. That is just for sports, when you talk about the entertainment options in Dallas. There are multiple gardens and parks throughout Dallas that you can take a stroll in any time. If animals are your thing the Dallas Zoo is one of the biggest in America. You will never run out of things to do, especially with a great night life also! Between sports and exploring the great city of Dallas, you will always be engaged which is perfect for a young person with lots of energy and things they want to do.

New York is the city that never sleeps, and that’s all you need to know about how recreation goes. Of course that’s not all, but New York does have almost unlimited amounts of ways to stay busy or go spend some free time doing anything that interests you. Sports, entertainment, dining, and night life are what make New York the City that never sleeps. You can go to any number of MLB games, NBA games, NFL games. They have multiple teams in each of those sports and then that isn’t even getting to the college level yet. If you choose entertainment, you can go to the Rockefeller center, Central park, or Times Square. IF you walk
out of your house you can find a bar or club almost anywhere to suit your nighttime habits, but if you’d rather go to a Broadway show, then of course New York can offer that also. New York is a place to work hard and play hard and there are endless options to do both here.

XIV. Travel

In order to get back from Dallas to Greensboro, NC the majority of times you would have to fly. If you chose to drive, each time it would be a 16 hr. trip if you made no stops and did not hit any traffic. Because of this fact, flying to and from Dallas would be the best option. Flying roundtrip to and from Dallas would on average cost you around 350$ but that is variable based on the time you book your flight and how far out in advance you book your flight.

New York is just up the east coast from N 8 hours 49 minutes. If you assume that gas is the market price of gas is 2.39 (National Average) and in order to drive the 508 miles it takes 21 gallons to get there. Both ways the total cost for 100.38 for just gas for the round trip. Depending on time I have if it is worth more to me than the additional cost of flying I will fly. The cost for a roundtrip would be $175 but it could go up or down depending on when you book it and how far out in advance you book.

XV. Operating Budget

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<th>Dallas</th>
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<td>$60,000.00</td>
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<td></td>
<td>Dallas</td>
<td>New York</td>
</tr>
<tr>
<td>---------------------------</td>
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<td>-----------</td>
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<td>City Taxes</td>
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<td>Annual Income</td>
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<tr>
<td>Apartment supplies</td>
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<tr>
<td>Income available per month</td>
<td>$607.13</td>
<td>$891.46</td>
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</table>

(all based on 2018 data)

(Texas no income tax)

As you can see adjusting for prices for both areas and using rough estimates when data was unavailable to be procured, living in Dallas provides a higher monthly availability of income. This does not take into account of property tax that for purposes of this statement could not accurately be reported so was therefore excluded in order to now skew data.

XVI. Analysis

After reviewing all of this, I used to really want to live in New York and be a part of the big Apple experience. After thinking about what I really want going forward and the kind of area that suits me best, I have to say that Dallas is by far and away the best city I have found. New
York has a lot of great amenities, but the traffic, the weather, and the level of taxes makes Dallas the place I want to be going forward and it is the best choice for my intentions.

**XVII. Knowledge gained**

I learned quite a bit from this case, far more than I figured that I would. Some of the most interesting things that I looked at were commute times and areas of rent and what they included near them. To me those were very serious factors because you don’t know exactly how where you live will affect you, but this case shows you how it matters so much. You have to completely change where you shop, eat, hang out, and even your daily routine based upon where you live. You don’t even need to change cities for example. In New York borough to borough can really change your scenery and make the experience and costs completely different. I learned in this case that Dallas has no city income tax or state income tax, so when you make money in Texas it feels a lot better than when you make the same amount before taxes elsewhere. The commute times really show you what the area is like, how dense it is, and how getting around in general besides just to work will be. Dallas showed me that I can get the parks and city access all while not living directly in the city, while with New York even living in the borough of Manhattan, the commute to Midtown was still 30 minutes. You have to really think about things before you make a decision and this case showed me that every decision we make going forward has big implications on the rest of our life.
Case 6: WorldCom Case

Ethics and Errors

Prepared by: Ronald Bristol

11/16/18
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I. Summary

This case allowed us as students to take a deeper look at the judgment decisions behind capitalizing a cost. This case was asking us to show along the way of figuring out what the correct scenario should have been which is the net loss position. I was able to see how the costs were incorrectly capitalized and be able to understand why this was occurring. We then had to almost act the part of the audit team and figure out what those costs where and if they were correctly capitalized or not. Then after using judgment to decide that you had to state how this would affect the certain financial statements that WorldCom has. The case was able to show us how an audit team would go into the financials of a company and decide how exactly the client was executing correct accounting principles.

II. Costs/Expenses

I. In my words, SCON 6 defines Assets as any benefit that will come about because of something that you own now or a combination of things you own now in order to produce a future economic benefit. Expenses in my words as defined by SCON 6 are any outflows of cash or credit that contribute to the entity’s major or central operations.

II. Costs must be capitalized when they are used in order to provide a future economic benefit to their current assets or when they provide an additional future benefit that was not already occurring within the firm. When the costs are used in the current year in order to provide additional benefits, those costs are to be expensed in order to allow for correct accounting principles.
III. Capitalization effects

Costs are capitalized according to how they are utilized by the company, but once costs are capitalized, they will be amortized or depreciated in order to recognize cost. The cost being capitalized will raise the asset level of the firm. If the cost was not capitalized it would be expensed instantly which would cause the cost of goods sold on the income statement to be higher and thus giving you an overall lower net income in the period. If you had capitalized it the Income statement would have a higher Net Income and you would have more time over which to expense the amortization of the cost or now “asset”

IV. Line Costs

Line costs, according to the company’s most recent annual report filed with the SEC, consist principally of access charges and transport charges. In my own terms, I would describe line costs as the costs that are aligned with the use of a third party’s equipment in order to gain access to the network. The journal entry for WorldCom should look as follows:

a. Line Costs 35,179,000,000
   i. Cash 35,179,000,000

V. Asset Capitalization

The costs that were paid to the third parties in order for access to be granted were the costs the WorldCom capitalized. This is seriously important because if you do not take a deep look it makes sense, WorldCom is using these assets in order to be able to make money now and in the future, so it technically seems like something that you could be capitalized. Now imagine if you were capitalizing one of your biggest expenses. It would completely change the way that your
balance sheet and your income statement look. The reason that these costs should not be
capitalized as assets and therefor making the way WorldCom did its accounting illegitimate, is
that these costs are not setting up the future use of an asset, these costs are used as an access
charge in order to be able to use the assets that other companies have set up. To me this would
not meet the terms for capitalization of an asset, because WorldCom still has to pay these costs
each time it uses the third party’s lines, so when you pay something say in year 20x2, you would
only be receiving benefit in 20x2. What WorldCom says is happening is that they are constantly
receiving economic benefited from these costs way after the year that they are occurring in.

B. Transmission Equipment 3,055,000,000
   a. Cash 3,055,000,000

The costs to utilize the third party systems were classified as transmission equipment. If this
has actually been expenditures for their own asset array of transmission equipment, then this
would be the perfect way to account for it. Instead they are purchasing access to another firm’s
equipment so you cannot debit an asset account because there is no tangible or intangible benefit
long term of spending money to access this service. On the balance sheet, these costs show up as
transmission equipment, and on the statement of cash flows they would appear in the investment
section because that is where purchase and sale of long term assets occurs.

VI. Effect of Errors

2001 depreciation expense by quarter: First Quarter $35,045,455, Second Quarter
$20,795,455, Third Quarter $16,886,364, and last but not least Fourth Quarter, $10,579,545.
That brings the total depreciation expense to $83,306,819, and the journal entry to account for
that would look like this.
a. Depreciation expense $83,306,819

   i. Accumulated Depreciation $83,306,819

The difference in Net income if WorldCom had done what they were supposed to do by accounting practices and expense the costs would be in a net loss position of $1,470,693,181. This difference in net income is almost at 5 billion dollars, and that kind of money is definitely material. In order to calculate for this, I used the initial Net Income, and using the difference of line costs and a tax rate of 35 percent I was able to come to the conclusion of their net loss position.

VII. What I learned

I learned a lot about how easy it would be to be a company and commit fraudulent activities. These frauds can be big in terms of magnitude or very small, and it just happened that in this case that what WorldCom did was extremely fraudulent and on a big scale. There are multiple reasons that can describe these actions, but the true fact of the matter is that WorldCom for some reason unknown decided that it would be expectable to try and cheat the system of recognizing costs so to say. I learned that what WorldCom did can happen anywhere at any time and it is up to the audit team to ensure this doesn’t happen because of the detrimental results that it brings. This all brings to question the way the earnings management is perceived by American corporations. They need to understand that in order to have true parity with the stakeholders, managing for earnings or managing to meet goals is not the way to go about it. Managing in order to raise your companies’ market share and managing the human capital in the firm are vastly more important tasks that when undertaken correctly, give you true earnings results you need.
Case 7: Starbucks Corporation

Understanding Financial Statements

Prepared by: Ronald Bristol

3/6/19
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I. Summary

This was a case regarding the innards of financials of a company. We had to look at the financials and be able to pick certain things out and use all of the financials as a whole in order to make decisions and give insight. We looked at a massive corporation that has many different business units and methods of operation so this case was a test as to one’s ability to read a detailed and correct financial report and answer various questions.

II. Starbucks Summary

Starbucks is in the nature on manufacturing, brewing, distributing, and serving coffee and like goods. Starbucks is composed of revenue streams from its stores throughout over 50 countries, Consumer packaged goods, and all of its food service operations. The ability of Starbucks to both serve clientele in licensed stores and have products available for distribution at gas stations, grocery stores, and many quick marts with similar products makes production and product transportation simpler than other manufacturers. Starbucks is a store that focuses on quality of product and the consumer pays that price, with brand reputation being another focal point for Starbucks growing to a global power in the quick service food and beverage industry. As a company, the global dominance has led to them leading the way in terms of revenue and ability to take on acquisitions and seek joint venture opportunities. Starbucks makes its money through mostly company stores and then smaller portions from its licensed stores and through its CPG.

Starbucks prepares the following financial statements for financial reporting:

5. Consolidated Statements of Equity

Those are the names that Starbucks uses to release the statements we know as,


The reason for the change in name is the use of the word Consolidated, and its purpose is to show that these statements reflect the whole entity that is Starbucks instead of showing the income statements and balance sheets for Starbucks and its wholly owned subsidiaries.

III. Responsibilities

Publicly traded corporations prepare financial statements periodically to its decision makers and for relevant people such as creditors and investors. According to the SEC publicly traded company’s release the 4 necessary financial statements listed above besides the Statement of Comprehensive Income. Meeting the standards set by the SEC allows these companies to be legally traded on public stock exchanges.

All management would be responsible for financial statements. Of all the management that is responsible for these the CFO and the CEO of the entity are the most responsible for the fair representation and integrity in their financial statements that they are releasing. Many people are interested in the financial statements of these entities, but the people who are most looking into them are creditors, lenders, investors, and customers. The statements that are released
portray the state of the company that those people are interested in. The information that they will likely be looking at is revenues and investments as well as the company’s ability to manage its debt. This also allows managers to see how they are doing in the big picture and allows them to ensure that their companies and employees are all well managed.

IV. Auditors

Starbucks external auditors are Deloitte LLP. They are responsible for the external audit of Starbucks Corporation. The first opinion letter that Starbucks was received stated that Deloitte as a firm had completed the audit as laid out by the Standards of the PCAOB. It further says that the Statements released have all been audited and are correct and in accordance with the Standards according to Deloitte. The Second opinion stated that Deloitte has been doing its internal financial reporting correctly and fairly and once again Deloitte is certifying that Starbucks has carried out its internal operations in accordance with the specific standards set. These opinions show the outside user and the management of the company that what has been released is true and fair and that Starbucks has not been deceitful or fraudulent in the reporting of financials. The opinions are dated so late after the dated of the financials because it takes time to ensure that the reasonable assurance provided by the opinions and the audit is correct and non-fraudulent.
V. Analysis

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Current assets:</strong></td>
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<tr>
<td>Cash and cash equivalents</td>
<td>$2,575.70</td>
<td>$1,188.60</td>
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<tr>
<td>Short-term investments</td>
<td>658.1</td>
<td>848.4</td>
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<td>Accounts receivable, net</td>
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<td>Inventories</td>
<td>1,111.20</td>
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<td>Prepaid expenses and other current assets</td>
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<tr>
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<td>Long-term debt</td>
<td>1,299.40</td>
<td>549.6</td>
</tr>
<tr>
<td></td>
<td>11.28%</td>
<td>6.65%</td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td>357.7</td>
<td>345.3</td>
</tr>
<tr>
<td></td>
<td>3.11%</td>
<td>4.20%</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>7,034.40</td>
<td>3,104.70</td>
</tr>
<tr>
<td></td>
<td>61.08%</td>
<td>37.77%</td>
</tr>
<tr>
<td><strong>Shareholders’ equity:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock ($0.001 par value) - authorized,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units),</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.8</td>
<td>0.7</td>
</tr>
<tr>
<td></td>
<td>0.01%</td>
<td>0.01%</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>282.1</td>
<td>39.4</td>
</tr>
<tr>
<td></td>
<td>2.45%</td>
<td>0.48%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>4,130.30</td>
<td>5,046.20</td>
</tr>
<tr>
<td></td>
<td>35.86%</td>
<td>61.40%</td>
</tr>
<tr>
<td>Accumulated other comprehensive income</td>
<td>67</td>
<td>22.7</td>
</tr>
<tr>
<td></td>
<td>0.58%</td>
<td>0.28%</td>
</tr>
<tr>
<td>Total shareholders’ equity</td>
<td>4,480.20</td>
<td>5,109</td>
</tr>
<tr>
<td></td>
<td>38.90%</td>
<td>62.16%</td>
</tr>
<tr>
<td>Noncontrolling interests</td>
<td>2.1</td>
<td>5.5</td>
</tr>
<tr>
<td></td>
<td>0.02%</td>
<td>0.07%</td>
</tr>
<tr>
<td>Total equity</td>
<td>4,482.30</td>
<td>5,114.50</td>
</tr>
<tr>
<td></td>
<td>38.92%</td>
<td>62.23%</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES AND EQUITY</strong></td>
<td>$11,516.70</td>
<td>$8,219.20</td>
</tr>
<tr>
<td></td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>
i.

Total assets ($11,615.70) = Liabilities ($7034.40) + Equity ($4,482.30)

So according to the Consolidated Balance Sheets provided by Starbucks, the accounting equation holds true.

ii.

Starbucks corporation has a lot of assets, but as summarized in their Consolidated Balance sheets, Property, Plant and Equipment, Inventories and Cash and Cash Equivalents are the major asset categories that Starbucks holds.

Short term assets: Current / Total = $ 5,471.40/ $ 11,516.70 = 47.51 percent

Long Term Assets: Non-Current/ Total = $ 6,045.30/ $ 11,516.70 = 52.49 percent

Yes, this seems appropriate, for the nature of its business it can be seen as acceptable or common to have numbers like this. The current ratio of around .9 is lower than the industry average of 1-1.5 but for the size and amount of equity that Starbucks has, this will be acceptable.

iii.

Intangible assets are usually long term or non-current assets that have no physical substance or things that are determined via a valuation and cannot be assessed in terms of tangibility. They have a useful life of over a year and can take the form off Licenses, patents, and Goodwill. Goodwill is difference in the fair value of assets acquired versus the fair value of the assets given up in order to acquire said prior assets. That excess of fair value is now goodwill for the company that got less in tangible assets. The valuation of Goodwill makes it such that it has an indefinite life as long as the two entities that took part in the transaction take part in the going
concern principle. Some of the specific intangible assets that Starbucks possesses according to its financial statements are: Goodwill, Tradenames/Trademarks, Copyrights, Patents, and any Acquired rights or trade secrets that they may have.

iv.

Starbucks is mainly financed through Debt, but also has a significant amount of equity. From owners and investors Starbucks has amassed an equity of $4,482.3 Million, but they have debt totaling just over $7000 Million. The proportion $7,034.40 / $4,482.30 = 1.569 shows that Starbucks has a bit less leverage because of the amount of debt it has both short and long term when compared to the investment by owners they have amassed.

VI. Revenues

Starbucks is a huge corporation, with many streams of revenue that include that following: 1. Consolidated Revenues, 2. Company Operated Stores Revenues, 3. Licensed Stores Revenues, 4. CPG, Foodservice and other revenues, and 5. Stored Value Cards.

a. Consolidated Revenues are recognized net of any discounts, returns, allowances and sales incentives, including coupon redemptions and rebates. They are also presented net of any intercompany eliminations for wholly owned subsidiaries and investees.

b. Company Operated Store Revenues are recognized when payment is tendered at the point of sale, revenues are reported net of sales.

c. Licensed Stores Revenues has many different categories within it and revenues from licensed stores consist of product sales to licensed stores, as
well as royalties and other fees paid by licensees to use the Starbucks brand. Sales of Coffee, Tea, and related products are recognized at shipment to the licensees. Initial nonrefundable development fees for licensed stores are recognized upon substantial performance of services for new market business development activities. Lastly in the Licensed Stores revenues, Royalty revenues based upon a percentage of reported sales and other continuing fees, such as marketing and service fees, are recognized on a monthly basis when earned.

d. CPG, Foodservice and other revenues primarily consists of packaged coffee and tea as well as a variety of ready-to-drink products received by the customer or distributor, depending on contract terms. Revenues are recorded net of sales discounts given to customers for trade promotions and other incentives and for sales return allowances, which are determined based on historical patterns.

e. Stored Value Cards revenue is recognized when redeemed or when it is deemed that redemption of the prepaid card is remote.

VII. Expenses

i. Costs of sales and store operating expense are the major expenses that Starbucks faces. In 2013 of all expenses, Costs of Sales was 42.38 percent and Store operating expenses are 28.87 percent.

ii. There were some significant changes to the cost structure, the most major of all of those was the occurrence of the litigation charge for 2,784 million dollars. This number greatly
increased the operating expenses from 2012 to 2013. Other increases in expenses from the previous year that were the most notable were Depreciation and Amortization expenses, and General and Administrative Expenses. They did have an increase in net revenues, but the litigation charges make the overall income not look as appetizing as it did in 2012.

iii. The litigation expense not included in the General and Administrative expenses because it was unusual in occurrence and in amount. Since the amount is both significant and material in nature it has to be included in the Operating expenses section, but the regularity of its occurrence allows it to not be reported in the General and Administrative section.

iv. The net margin of 10.4 percent in 2012 dropped steeply to .06 percent in 2013 and a lot of that I contribute to the litigation charges. The company still is profitable to me as it is recording revenues greater than its expenses for each year and of all expenses that are of necessary occurrence Starbucks has enough liquidity to be able to take care of those and continue business. The company was more profitable in 2012 than in 2013 but even in 2013 the company was still able to pay dividends which shows the long term strength and profitably that Starbucks has.

VIII. Statement of Cash Flows

i. Net cash provided by operating activities is the representation of the final output of the cash flow statement and for 2012 and 2013 Starbucks had Cash provided by operating activities $1,750.30 and $2,908.30 (both in millions). This number constitutes Net earnings from operating activities and adjustments to reconcile net earnings to net cash. The Net earnings for 2012 and
2013 (both in millions) are $1384.7 and $8.80 respectively. The major reason for this is the litigation expense but the fact that Net cash to Net earnings drops so fast between these 2 years can mostly be attributed to the massive litigation charge. Net earnings is the amount you have left over from sales revenue after you handle all operating expenses. The fact of the matter is with net earnings, a strong business will have a bigger amount of cash and that will show its liquidity capabilities, without a decent amount of cash it will look a bit of a red flag to all interested parties in the company’s future. Thankfully for Starbucks the litigation charge has a lot to do with this and so investors will not worry as long as they are reassured there are not more instances like this to look forward to.

ii. In 2013 Starbucks made additions to Property, Plant, and Equipment of $1,151.2 Million. This figure is increased from years past which has gone up around $300 Million each year since 2011. The interesting thing is that although just raw spending has gone up, Starbucks spends less on investments in PPE now than in previous years in proportion to Total assets.

iii. Starbucks declared $666.87 million worth of dividends in the year of 2013, and from the Cash Flow Statement paid $628.9 millions of those. This is pretty good in terms of percentages of dividends actually paid out which is 94.3 percent. This lack of 100 percent payment though brings the accrued dividends payable up to $195 Million now. Starbucks will eventually have to pay those dividends as they are accrued dividends declared.
IX. Estimates

Starbucks has a section in their notes to financials labeled Estimates and Assumptions. Within all of the financials it was necessary for use of estimates as in preparation of financials it is always unavoidable in terms of utilizing estimates to get the best and most accurate measurements of some financial data. The answer to what Estimates Starbucks utilizes is verbatim as follows: “estimates for asset and goodwill impairments, stock-based compensation forfeiture rates, future asset retirement obligations, and inventory reserves; assumptions underlying self-insurance reserves and income from unredeemed stored value cards; and the potential outcome of future tax consequences of events that have been recognized in the financial statements.” It also states that it is not limited to just these estimates and that these are merely examples of which estimation and assumption would be necessary. Some of the accounts in which this would take affect are as follows: Account receivables and allowances for bad debts, Short Term Investments Equity and cost investments, Goodwill, Intangible assets, Property, Plant and Equipment.

X. What I learned

I learned how things on Financials better related, and how consolidated accounts differ from straight up financials by just the main operating system. I was able to learn how to go about searching financials for clues and what accounts are big tells for certain things. Financials are really the guts of a company and this case allowed us to get more familiar with documents that need to be understood in order to increase our knowledge base.
Case 8: BP p.l.c.

Contingencies

Prepared by: Ronald Bristol

4/3/19
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I. What I learned

I learned from this case the many ins and outs of liabilities, especially contingencies. What I learned that I had not even thought about before the case was the scope of the accounting and estimation that occurs for something like an oil spill. Liabilities are hard enough to estimate but when you have something like an oil spill, the thought that goes into the contingencies must be clear and concise. This can be hard to wrap your mind around because you think clear and concise must be easy, but in terms of the oil spill we see that so many different entities can be affected and so many regulations are in place surrounding the oil industry that BP had liabilities due to people and business of all kinds.

II. Contingent Liabilities

A contingent liability is a liability that could occur in the future. The reason we classify them as contingent liabilities and do not wait for the liability to occur in order to record them is that these future liabilities are likely and can be reasonably estimated. Some of the most common types of contingent liabilities are lawsuits that are pending and product warranties. For example, when you buy a phone through apple and you purchase the apple care, they would recognize a contingent warranty liability because over that period if your phone breaks they fix it because of the warranty you purchased. Both the IFRS and the GAAP require companies to record contingent liabilities. Companies may record contingent assets in the notes to the financial statements, but they can never record them until the gain is realized. So unlike with liabilities, even when it is probable and can be reasonably estimated, you do not record a gain contingency until it is realized.

From the perspective of BP, the warranty protects their purchases for the 2 years that it covers.
That means they look at the value of those telescopic joints as being fully covered in value for those 2 years because if any defects occur, GE Oil and Gas is liable to replace them. BP would consider the warranty a Contingent Asset, but there is no recording of those, so they would disclose this warranty coverage in the notes to the financial statements. This is because the Telescopic joints are covered by a 2 year defect free warranty and for those 2 years BP can get new ones as long as they are defected. From the perspective of GE Oil and Gas, the warranty is a contingent liability because if any defect occurs they have to pay for the replacement as stated under the warranty terms. The likelihood of this happening and the amount estimated to take care of the warranties is what will be reported as a contingent liability for GE.

When a loss is likely to occur, companies record the contingent liabilities. That is one of the main judgments that occurs because this “likely to occur” can be hard to come by. In order to record the liabilities accurately, both likeliness of occurrence and having a reasonable estimation of the cost to fulfill the warranties must be present. The accounting for the liabilities and accrued warranty costs differs if the likelihood of these events is probable or reasonably probable. If the event is probable it will take a direct effect on the financials as an expense and a liability account will be affected. If the event is only reasonably probable or sometimes in the case of remote, the facts of the situation will be disclosed in the notes to the financial statements. The claim for damages resulting from the spill result in many different kinds of liabilities because the extent of the event was so wide spread. The spill results in many current and non-current liabilities that BP can estimate, but at the same time they still have to include in the notes that they are still subject to significant uncertainty about all the obligations that will arise as a result of the spill. This differs greatly from the piece of equipment claim because that does not result in many changes over the next few years. That warranty claim will result in a solution rather fast and the
accounting for it is not nearly as complex as the spills results because of the magnitude of the event. The amount of uncertainties in timing and amounts of payment from the spill are very hard to come by as the notes of BP state, but the amount and timing of the warranty claim is way easier to come by. BP will have to continue recognizing the current best estimate of those provisions until all claims of damages and need for repayment are fulfilled.

**III. BP payments**

BP got very unlucky with the scope of the effected in its case of the oil spill. From having to pay to the commitment to the Gulf of Mexico Research initiative, estimated legal costs are expected to be incurred in relation to litigation. In Continuation of those payments, BP also has to make payments to the escrow account, the claims center, and estimated penalties under the Clean Water Act. All of these amounts are reasonably estimated and will be included in the financial statements. Further estimation is required in terms of offshore operations costs that go along with the US Coast Guard response costs, and decontamination of vessels involved in the spill response. The costs for shoreline response also have to be estimated and according to the statements made by BP in their notes, they expect those to be incurred and paid within 12 months. More estimates must be made for Natural resource damage resulting from the oil spill, but in order to determine this effect is quite difficult. BP has decided to have the Escrow account available at all times to pay for the ongoing natural resource damages that will be incurred. These cases are all subject to a very high degree of ongoing uncertainty so these estimates cannot contain all the necessary payments required by BP in order to settle this oil spill with all those affected.
IV. Discussion of Estimates

As an auditor for BP in terms of drawing a boundary around expected losses, you would have to take a full scope look at how far this oil spill goes. You would need to look at how far inland the spill goes and see how many people it has affected of the general population. You would have to look at every shoreline business that got effected by the oil spill and how they might be able to sue BP for compensation. In terms of industries that could have been affected by the spill, the Fishing and Luxury Vacation industries would be greatly affected by the loss of their resources that they could sell. In terms of fishing industries, BP would have to estimate how many fish the oil spill had contaminated and how many of those would usually be caught and sold by the many fishing companies off the Gulf. In terms of Travel and Vacation industries, BP would have to look at how the oil spill affected the coast and affected the ability of these industries to have people come to the GULF. These possibilities are almost endless as these industries can do so much in the area surrounding the spill and the oil was so large in terms of quantity spilled.
Case 9: The Wendy’s Company

Equity Method Investments

Prepared by: Ronald Bristol

4/12/19
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I. Summary

The Wendy’s Company – Equity Method investments case covered a real life situation in which Wendy’s and Tim Hortons entered into a “joint venture” called TimWen. It discusses the financial statement treatment for the activities of an equity investment when significant influence occurs. The case covers topics from gains and losses on equity investments, to dividends received from equity investments, to income share with equity investments, and their effects on the financial statements. The Wendy’s case offers a look at the notes of a financial statement and makes the student look at the relationships of the financial statements and how the notes give a deeper look into those numbers. The case also covers how initial investments are treated on an accounting basis and what happens under the equity method. It lastly gives us a look at how the specifications of the equity method can affect the statement of cash flows.

II. Joint Ventures and Equity Investments

Joint ventures are great for companies. They allow sharing of risk between both of the companies. Joint Ventures also allow for companies to share information and talent between themselves in order to expand further. The sharing of resources allows companies to take on bigger tasks and bigger areas without expanding the risk as greatly as if they tried to expand purely through acquisitions. The two companies enter in to a Joint agreement and this allows for Joint Control. Joint control is when each company has a say financially and managerially in what the new joint venture company does. These business work as partners in order to make sure that the new project they are both trying to achieve works. The usual reason for the Joint Ventures between companies are because of technological, geographical, or logistic differences between the two companies. They both see competitive advantages of each other and figure that if they
work together they will be able to accomplish more than if they were separate. Joint ventures are not takeovers; they usually result in a subsidiary company between the two parent companies. In our case of this Joint Venture, Wendy’s does not donate any tangible goods, i.e. machines or franchises, but they donate money to the “Venture” in order to have a 50/50 control split between them and Tim Hortons. This technically is an Equity Investment as no technical real subsidiary was created, but the legal nature allowed this to still be considered a Joint Venture.

**III. ASC 323 Equity Method Accounting**

ASC 323 pertains to the equity method of accounting. It is described to be the best accounting method for Partnerships, Joint Ventures, and Limited liability in situations in which the investment enables the investor to influence operating or financial decisions significantly. What the Equity method is, is an accounting method used to show how an investment with influence could affect your investment. Other entities business decisions and their results will raise or lower the level of your investment because of the influence you have over their operations. In our situation Wendy’s and Tim Hortons both have a significant influence in the new company TimWen. The basis of the Equity method allows companies to be affected on their financial statements by investments they make if they allow significant influence. This means that under the equity method when the subsidiary company makes a net income, the parent company gets a portion allocated to them represented by their interest. This portion increases the amount of their investment instead of just giving the parent company more cash to work with. That is also why when the subsidiary pays out dividends to owners, this act decreases the investment amount of the parent company. If you take a balance sheet approach to this, you will see the accounting behind it. As the subsidiary makes money i.e. Net Income, it becomes
worth more overall as equity of that company will go up. The investor does not gain cash from this, but since they have a significant influence they also need something to increase their investment to match with the level of success the company is having. So the portion of Net Income that is allocated to the parent company just increases their investment so that same initial controlling interest the parent company had can stay the same ratio wise. When the subsidiary pays out dividends, they are reducing the equity overall of the company by distributing to owners. Since the owners are getting cash, and the value of the subsidiary is decreasing, under the equity method since the investor has significant influence, the cash they get also decreases the amount of the investment accordingly. If this balance did not happen, the investor would own a bigger share in the company than before if the amount of the investment stayed the same but the overall equity of the subsidiary went down. This makes the equity method necessary when there is a significant influence by a company as to correctly represent the financial workings correctly on the financial statements.

**IV. Acquisition Accounting Premium**

Companies often invest amounts that are greater than the book value of the net assets. When this happens the company that is investing paid more than the equity per share. The excess purchase price past the right up is considered good will, but more specifically excess is called acquisition accounting premium or AAP for short. Part of the excess, the AAP, is used to write up the identifiable assets and liabilities to fair value. The excess of the excess, Goodwill, is not written off with depreciation like the AAP, but instead is constantly tested for impairment. The AAP that contributes to the write ups is written off with the depreciation of those assets. This all occurs under the equity method in order to ensure that correct amounts of assets and liabilities
that get written up. This is also to ensure that the valuation of them is all recorded and written off in the correct manner depending on the specific accounting. If this method was not used, the goodwill would not occur and the write off would come directly from the expiration of those assets and liabilities. The adverse effects of this would leave your balance sheet way different after an acquisition than if you would record this all under the equity method.

**V. Tim Hortons**

For the years 2012 and 2011 Wendy’s reported $89,370 and $91,742 (in thousands) respectively in their Joint venture with Tim Hortons. They label it a joint venture because of the legality of the situation and the nature of Wendy's investment. Tim Hortons is still operating all their stores, it's just that now Wendy’s is able to share in those profits because of their Equity Investment. In the balance sheet in the Assets section this is lumped in with the other various investments that Wendy’s has, but when you look closely at the notes to the financial statements it dissects the investments further so you can see what Wendy’s has invested with Tim Hortons.

**VI. Joint Venture Revenues**

Wendy’s recorded the amount at the end of 2012 as $89,730. This number was taken directly from the notes to the financial statements under the investments section, specifically note 8. When you compare this to the Equity reported under Tim Wen and know that Wendy’s owns a 50 percent share in that you find that amount to come out to only $35,282. This leaves an excess in amount of $54,088. This turns in to AAP as discussed early in this case which will be used to bring the value of the assets and liabilities up to Fair Value. This means that if the AAP was not used all the equity purchased would have been worth way less. Since Wendy’s investment was
such a large amount they will write up all the assets to their new fair value. Wendy’s must have seen something in Tim Hortons that they thought would be worth the price of the investment and after writing up to fair value any leftover from the AAP becomes Goodwill. The Joint Venture with Japan actually sees a negative balance in the year ended 2012. That is possible and just means that the venture is on a downward turn and things are not looking too good for that investment.

**VII. Equity Earnings**

i. 

The investment in Tim Wen helped Wendy’s make more than if they had not actually made the investment. For 2012 and 2011 Wendy’s share of the earnings was 13,860 and 13,505 respectively. The amortization in those years of $3,129 and $2,934 respectively allowed for the Earnings before taxes in 2012 to be $10,551 higher and in 2011 be $10,571 higher. Wendy’s reports its earnings in the consolidated statement of operations under the title “other operating expenses, net”. This is where the Equity increase is shown net with other operating expenses so that Wendy’s has accounted for the Equity income correctly.

ii. 

Equity Investment 13,860

   Equity income 13,860

iii. 

The journal entry to record amortization of the purchase price adjustments involves a debit to Equity Income and a credit to Equity investment. This shows the decrease in value of your investment and shows the loss attributed to that.
In order to find what the revenue from dividends that Wendy’s had from TimWen, look in the Consolidated statements of cash flows under the distributions from TimWen Joint Venture and you will see the dividends paid in 2012 and 2011. In 2012 Wendy’s received a dividend payment of $15,274 and in 2011 they received a dividend revenue of $14,942. This receipt of cash decreases the amount of the investment under the Equity method. The journal entry for 2012 looks as follows:

Cash 15,274
Equity Investment 15,274

VIII. Equity Adjustments

i.

Equity in earnings in joint ventures, net of $8,724. This negative adjustment is needed to correctly show the cash adjustment of Equity in Earnings for what occurred. Since it was a non-cash transaction you have to subtract the earnings from the net income value for the statement of cash flows. This is because while the earnings were included in net income for cash flows you have to subtract it because it was non-cash to get to the correct net income amount. In note 8 you look to the title equity in earnings under investments for 2012 and see after amortization price of $10,551 this netted with the equity in losses of ($1,827). This results in an equity earning of $8,724 included in net income. Thus the adjustment of ($8,724) is needed to get to the correct cash net income.
The reason that the operating section reports a positive adjustment is needed because Wendy’s made cash on dividends. The amount needed for the adjustment should be the same as the amount listed under the distributions received in the notes to the financial statements. Under the equity method the distributions received reduce the amount of the initial equity investment. In order to reach the correct amount for cash you have to add back in the deduction from net income that was the dividends received. A positive adjustment of $15,274 is needed because the overall net income was reduced because of the dividends.

**IX. What I learned**

I mostly learned from this case that while the financial statements of a corporation are important, but that the notes to the financial statements can be super revealing to what is going on in the statements. In order for one to correctly look at the equity earnings cash flow you would need the notes in order to determine how that number had been reached. The note 8 was necessary to be able to determine where all these numbers in the earnings, cash flows, and balance sheet accounts. I also learned how the Equity method changes the method of accounting for investments. Under the equity method the company you invested in becomes more a part of your company especially as displayed on the financial statements. The way the dividends and earnings share of the subsidiary affect the investment of the parent company instead of just receiving dividends and that being your only investment income. This method of accounting is better at showing how much that investment is actually work in accordance with the workings of that company that was invested in.
Case 10: Johnson & Johnson

Retirement Obligations

Prepared by: Ronald Bristol

4/19/19
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I. Summary

This case asked us to look at the company Johnson & Johnson and their Retirement plans. The case asked us to break down the kinds of benefit plans and their effects on both employer and employee in terms of funding and benefits. When looking at Retirement plans, you have to go deeper in to them to find all the factors that play a role in what is due and what the employees have earned. From service and interest cost, to return on assets this case allowed us as students to see just how a pension obligation in a real company really functions. The case of Johnson & Johnson showed how much of an obligation pensions are to companies, especially to companies with the number of employees owed benefits like Johnson & Johnson.

II. Pension Obligations

Defined benefit plan and Defined contribution plans are both used in order for companies to put away money to cover Pension Obligations to their employees at retirement. Defined benefit plans require a formula that takes into effect various aspects of a company’s employees and determines a funding plan based off that formula. The company then makes contributions to the plan each year as required by the plan. These contributions are held by a 3rd party separate from the company and its employees. With a Benefit plan, the benefits are guaranteed by the plan, and the funding can vary in regards to what actuaries determine to be necessary each period. This places more risk on to the employer as the employees are guaranteed their benefits by the plan and the employer has to do the funding. The other option that is getting more and more popular requires the employee to partially fund the plan along with the employer. The employer has a defined contribution plan, which means their funding is fixed, and the employees have to contribute to the plan in order to receive more benefits in the end. When you look at Johnson and Johnsons obligations, you see that they sponsor various retirement and pension plans.
plans, including defined benefit, defined contribution. As disclosed in note 13, they use both kinds of plans for their employees.

**III. How Pensions Function**

If you take a step back and look at the total picture behind Pensions, you will see why they are liabilities to the company.

1. Sponsoring Company -> sends payments to holding firm
2. Holding firm -> invests assets into vast portfolio
3. Returns and dividends on said investments -> return that benefit the plan
4. Holding firm pays out retired employees benefits -> decrease the plan and the outstanding pension obligation
5. Employees work more years -> calls for sponsoring company to fund more into the plan.
6. Sponsoring company -> funds the holding firm again to meet obligations.

These obligations create liabilities for the sponsoring company, as they have to continuously fund the plan in order to meet the obligations for their employees. The holding firm is able to invest those assets and the returns on those investments increase the benefit in the plan without sponsoring company funding. Any increase in benefit owed by the company that is not covered by return on the assets is a liability that the company has to pay.

A main return has to be accounted for and then compared with the actual return, as you have to make an assumption in order to know what kind of funding will occur within the plan. Actuaries make predictions (called *actuarial assumptions*) of mortality rates, employee turnover, interest and earnings rates, early retirement frequency, future salaries, and any other factors necessary to
operate a pension plan. These are all assumptions that are used in order to account for retirement plan obligations.

IV. Increases/Decreases in Obligation

There are four main things that increase or decrease the pension obligation. The main one that is determined each year by the actuaries is the service cost. Service cost is the total necessary needed to fund the plan based on the formula that the actuaries came up with. This means that for each year your employees work, there is an additional service cost in order to cover that year’s benefits owed. The service cost increases the pension expense of the sponsoring company. Actuaries also determined a settlement rate, and the sponsoring companies have to pay interest based on that settlement rate each year. The initial outstanding balance in the Pension Benefit Obligation multiplied by the settlement rate determines the interest cost that the sponsoring company has to account for each period in the pension plan. The interest cost also increases the pension expense and the benefit obligation. The actuarial gains and losses are the losses or gains incurred in differences in what actually happened versus what was expected to happen. If you have a pension plan that has greatly increase actual returns over expected returns, this will reduce your pension expense. The flip side can be said for the expected returns being greater than actual returns, as this will cause a loss to the sponsoring company and they will have a greater expense that period. If the actuaries change anything in the formula, you can have a loss or gain with the Pension benefit fund greatly increasing or decreasing unexpectedly. The actuarial gains and losses can greatly increase your PBO or they can decrease your PBO. This effect will only be
accounted for after the fact, as you cannot estimate that the actuaries will change between period to period.

**V. Effect of Expected Returns**

The pension plan asset gets increases by the expected returns determined by the actuaries, and if the actual return is higher, then the plan gets increased by even more and you have an unexpected gain. The actual return on plan assets is the return that the holding firm was able to achieve with its investment portfolio. This decreases the amount of pension expense that you have for the period. The pension asset can also be increased with company contributions. According to the plan, the company will have to make contributions each period in order to be able to pay these benefits in the future to their employees. The contributions increase the pension plan, but decrease the sponsoring company’s assets such as cash. These contributions are the monetary amount that the sponsoring company is contributing each period to the plan. These plan assets are where the benefits paid come out of. As the holding company pays the benefits to the employees, they pay them from the plan, so each payment reduces the carrying amount of the plan. All three of these factors affect how much is left in the Pension plan asset at the end of the period, with only the benefits paid being able to reduce the Plan. If you have expected returns that are greater than actual returns, you don’t reduce the plan, instead you have a loss on returns and you have to pay more in pension expense in order to cover that unexpected loss.

**VI. Pension Expense**

Pension expense gets reduced each period through the expected return on plan assets. The pension expense uses the expected return to reduce market-induced volatility in the income
statement Plan assets get increased by the actual return on plan assets. They both have return on plan assets, but they differ slightly. The expected return is used in order to offset some of the pension expense each period, with any losses on expected return increasing the pension expense. The plan assets get increased by the actual return, and if the expected return is differing that will show in the pension expense. This is because you don’t account for a change in assets based on the expected return, but the actual return. That is why the Pension expense entry is where you see the difference in the actual and the expected returns. The actual returns are the returns actually put off by the investments of the plan assets, and the expected returns are derived from a formula that the actuaries determine.

i. In 2007 Johnson & Johnson reported net periodic benefit cost of 646 million. Net periodic benefit cost is another term for pension expense. You can find this number in note 13, under the retirement plan header. This number is the net of the service cost, interest cost, expected return on plan assets, actuarial losses increasing pension expense, and a few others.

ii. 2007 service cost was 597 million and interest cost was 656 million. The entry to increase pension expense and the PBO would be:

\[
\text{Pension expense} \quad 1,253 \\
\text{Pension Benefit Obligation} \quad 1,253
\]

VII. Pension Interest and Obligation

i. On December 31, 2007 Johnson & Johnson had a Retirement plan obligation of $12,002 million. This is found in note 13 under change in Retirement plan obligation under 2007’s heading. This number represents the total obligation owed to employees including the current year’s additions due to the service cost, interest cost, etc.
ii. the pension related interest cost was 656 million. The Pension benefit obligation and amendment to service cost are added together to find the actual cost to multiply by the settlement rate in order to find the interest cost. The rate that Johnson & Johnson are getting is 11,674/656 = 5.62 percent, and when you compare this to international and US average settlement rates of 5.5 and 6.5 respectively would place Johnson & Johnson in a solid position and would make this rate reasonable.

iii. Each year Johnson pays out benefits from the plan to the past employees who are in receipt of the benefits. The 2007 benefits paid out were 481 million. This is not a cash payment for Johnson & Johnson. The benefits are paid out using the Plan, and they reduce the plan assets in the holding firm. There is no effect on the assets inside of Johnson & Johnson for this transaction as it all occurs between the holding company and the employees. The result of a payment of benefits is to reduce the plan assets and reduce the benefit obligation.

VIII. Plan Assets.

i. At the end of 2007, Johnson & Johnson have a retirement plan asset value of 10,469 million. This is recorded at fair value and it is found detailed under change in plan assets in note 13.

ii. The plan asset had a return of 743, which is actual return on plan assets. Expected return was 809. Both of these values are in millions, which means that for 2007 Johnson & Johnson had an unexpected loss, and if the excess was over the corridor determined, they would have to amortize some of this cost. The actual return better reflects the pension assets because it shows that which the plan actually earned, but the expected return reflects what was
thought to occur and is why it is used to offset the pension expense. This means that pension expense would be greater than thought of since there was a loss due to return differences.

iii. Johnson & Johnson had a contribution of 317 million compared to their employees of 62 million in 2007. This is an increase in both areas from 2006 as those numbers were 259 and 47 million for each of the entities listed above. The contributions are both increases to the pension plan asset, which will eventually be used to pay of the benefits due to employees.

iv. In their plan assets, Johnson and Johnson has numerous amounts of investments. That is how they get returns on the plan assets which increase those assets and reduce the pension expense. Johnson & Johnson has investments in debt and in equity securities which allow them to make returns. If you look in the notes you will see that Johnson & Johnson has 79 percent of plan assets invested in Equity securities and 21 percent invested in Debt securities.

IX. Funding level

The Pension benefit obligation total at the end of 2007 is $12,002 and the plan asset fair value at the end of 2007 is $10,469, both in millions. This means that the plan has an underfunded amount of $1,533 million at the end of 2007. If you look at the balance sheet for Johnson & Johnson, you will see that they have total employee related obligations liability of $5,402 which is the total amount that the plan has been underfunded by. In 2006 the plan was also underfunded by $ 2,122 million. So for both of the years 2006 and 2007 the outstanding obligation on the balance sheet of Johnson & Johnson was increased.
X. What I learned

I learned how important actuaries really can be to a company like Johnson & Johnson. The expected and actual returns can greatly affect what they have to account for in terms of Pension expense. I learned a lot from this case about the inner workings of Pension plans, especially how there is a holding company that invests and gets returns for the contributing company. If you take a step back and look at pensions, you will see how what goes on with the actuaries and the returns can really affect what Johnson & Johnson has to account for and what they have to count as an actual obligation liability. The case mainly showed me just how big of an obligation pensions can be for some companies and how important it is to have a good estimation team in order to not constantly be losing or gaining based on actuarial changes.
Case 11: Center for Excellence in Accounting and Security Analysis

Balance Sheet-Based Model of Financial Reporting

Prepared by: Ronald Bristol

4/26/19
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I. Summary

The Center for Excellence in Accounting and Security analysis (ceasa) released a paper On the Balance Sheet-Based Model of Financial Reporting in 2007 that essential was examining the flaws of the Balance Sheet-Based Model. The paper argues in point of presenting the current flaws with this model of financial reporting. It brings forth the fact that FASB has operated under this model of financial reporting since the mid to late 1970’s, essentially the time frame when FASB took over for the APB (1973). The APB had been based on the income statement approach to financial reporting and it had been since Paton and Littleton wrote what was to be called “The Accounting Book of the Century” in 1940. This book was based off of the income statement approach which placed primary emphasis on income statement concepts (revenues/expenses) and a more peripheral status for balance sheet considerations. The balance sheet approach stems from the view that proper valuation of assets and liabilities will lead to a correct determination of earnings. The paper argues that this method of proper valuation of assets and liabilities to determine that earnings is simply the change in net assets over a period has strong links to economics where this is similarly defined as Hicksian income. The method that the paper argues paying more attention to as a basis for the conceptual framework is the income statement approach. This approach places the determination of revenues, expenses, and earnings as the primary goal of financial reporting. This means that a greater emphasis is placed on the timing and the magnitude of revenues and expenses and that balance sheet considerations are secondary and derivative of those revenues and expenses. The paper claims investment managers and analysts think of a stock’s value as arising from a firm’s ability to generate earnings, and so therefor earnings and their proper determination should be the primary goal of financial
reporting, not deriving earnings from asset and liability differences. When FASB was instituted had to reach a conclusion on how to account for financial reporting in order to develop a sound and firm conceptual framework. This was necessary as the results of FASB’s decision would have a large influence on the future standards and on the economy. FASB came to the determination that the balance sheet-based model would be the cornerstone for standard setting as it was the most conceptually sound basis. This was derived from the fact that in order to determine earnings you must define what value is, since at its essence, earnings are a change in value concept. The income statement approach was seen as more suspect because of the supposed vague concepts like matching and the questionability of assets and liabilities due to accruals and deferrals created by this approach. Since then FASB has been spreading the basis of the balance sheet approach both in terms of rules within the framework, and geographic acceptance of the framework. In the way of rules, FASB has moved towards the more extremes of the balance sheet approach, with the likes of fair value accounting. SFAS 133, 141, 156; which deal with hedging, acquisitions and goodwill accounting, and securitization, respectively, all deal with implementation of fair value accounting into different areas of the framework. Especially SFAS 156 which allows fair value accounting for a broad range of assets and liabilities. In terms of spreading geographically FASB and IASB began coordinating their activities and philosophies by way of “The Norwalk Agreement” in 2002. The joint committees created by this approach have a firm commitment then to the balance sheet method. As of 2006 FASB released their “Preliminary Views” document which is a summary of current thinking on the conceptual framework. The release of the document also stands for feedback to be given in order to be able to develop an Exposure Draft. The document states the FASB has decided the best course to take going forward with the conceptual framework was to iron out the
inconsistencies between the two approaches to financial reporting, rather than reviewing the fundamentals of the framework and the foundation of those. The reason for writing this paper was that FASB was re-considering their conceptual framework at this time and this would be a good conversation starter in the world of financial reporting, especially regarding the ironing out inconsistencies of income statement to balance sheet-based approaches. The paper places forth four points of critique on the Balance Sheet-Based Method that should be considered when re-evaluating the conceptual framework of both FASB and IASB.

II. Standard Business Operations vs. Balance sheet approach

The first critique brought to our attention was that the balance sheet approach to is at odds with how most businesses operate. Ceasa states that most firms “are essentially sophisticated devices for continually advancing expenses, hoping to earn revenue and earnings”. By this logic, assets are considered supplementary devices to the fundamental purpose of earnings. If assets were the primary goal of a firm, meaning essentially that firms were growing assets and the growth of these was considered income, then the balance sheet approach would make more logical sense. The paper argues that in essence firms are “asset furnaces” where assets are “sacrificed or transformed” in order to reach the overall goal of producing revenues and earnings. The argument presented states that assets are temporary implements in order to carry out the business in order to make revenues. This is furthered with the fact that many firms operate on the project by project basis when making decisions and that revenues and expenses are used in determination of continuance on this project or the scrapping of it. The argument states that if you look on the horizon of a firm, the whole firm is in essence a machine for revenues and expenses and those transfer over to earnings. That assets at the final point are all
gone and the only thing representative of the firm are the cumulative revenues earned and costs and the resulting earnings. FASB recognizes investors as the most important users of financial reporting, and they use income statement considerations when making decisions, and most managers use an income statement mode of operations in order to manage their firms; the paper presents this as a great fault in the conceptual framework. The point is that the balance sheet approach is not as focused on concepts of business model and business performance, which is how the world in reality functions at its basis, but focuses on assets values instead. The paper states that this diverts attention from operations, which are key to the value of a firm. The balance sheet approach makes firm value appear as a storage of resources, whereas the income statement approach puts revenue recognition comes first, which is then followed be recognition of expenses and therefore an income. They argue that in recognition of PPE values, the balance sheet method only makes logical sense for those firms that operate mainly on marketable securities, but that the for PPE in terms of value in use and fair value the income statement approach is preferred. PPE is mostly used by firms that are using that PPE to create something that they can receive revenue from, and so the value that should be derived for PPE should not be fair value, but value in use which relates to the income statement approach. The closing for how the balance sheet method is at odds can be riddled down to balance sheet methods are seen to be at odds with most firms for operating activities, because those firms are using those assets to produce something else, and not holding them for sale. The balance sheet approach is seen to have use in limited and specific circumstances, but for process of value creation for most firms, the income statement approach is more logical and fundamentally aligned with the reality of businesses.
III. Discussion of Superiority of Balance Sheet Method

The second critique brought to the reader's attention is that the alleged superiority of the balance sheet method is unclear. This is because FASB considers asset’s as a concept to be the most fundamental and important of all accounting concepts, and that all other concepts are derivatives of assets. The claim is that FASB defines assets “Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events”, in which benefits sound very similar to earnings. This in turn brings shows that there is circularity to that argument, because FASB says asset determination is primary, when in order to determine those assets value we define them in terms of expected earnings. FASB also suggests that the two concepts can be divorced and in effect have one more important than the other. The argument sums around the fact that in order to value assets correctly, a stream of earnings must be projected in order to reach the best value for the asset. As a result of this effect, most assets today are difficult to grasp conceptually and in terms of operational usefulness are really becoming less useful. The main need for the income statement approach revolves around the fact that most assets today in firms are intangible assets account for a majority or large portion of almost every firms’ assets. The valuation that goes along with this accounting based on the balance sheet method brings lots of volatility to earnings and we can see this through the fact that the average firm market to book ratio is much higher than 1.

IV. Effect on Earnings

In furthering that point that the conceptual superiority is unclear, the third point brought forward testifies that this consideration is a “major contributor to substantial temporal decline in the forward-looking usefulness of earnings”. This means that because of the mass use of
valuation and the shade that gets thrown on earnings because of that valuation that earnings in terms of being a predictive value is becoming less and less important. What most investors look at according to the paper are recurring earnings, or more specifically the current earnings that predict the best value for the future stream of earnings. Thus the current way of determining earnings through change in assets according to the balance sheet based mode does not comply with the way major users of financial statements look at information. The paper proves that earnings are becoming less and less useful under the balance sheet-based model based on the following facts. For the last 40 years the earning properties of the 1,000 largest US firms have doubled in volatility and earnings persistence has fallen from .91 to .65. The study states that the reason for these effects is not because of the changing values of revenues, expenses, and cash flows because these have actually stayed steady throughout the period, but more due to the fact that earnings are changed more by the changes in accounting rather than the real economy. To further this a study by Collins, Maydew, and Weiss (1997) found that stock prices and earnings have become steadily weaker in relationship. The paper concludes that these all put together show that the balance sheet-based model of financial reporting has produced a deterioration in the forward usefulness of earnings. The consequences of this if left unchecked can do multiple things; the lacking in usefulness in earnings could pose a threat to accountings utility as a profession, and the investor market could continue to stratify because of the difference in investor knowledge of what actually predicts firms’ future value. Ceasa states that FASB ironically is in charge of standard setting in order to level the playing field of financial markets, because in effect the balance sheet-based model is producing the exact opposite of this intended result.
V. Problems in Practice

The fourth and final point brought forward is that at its basis, the balance sheet approach has problems in practice. If you go to the basis of the balance sheet model, market to market valuation is the correct way to value assets and liabilities, but because market data isn't available for every kind of asset in every situation, the balance sheet model takes on more of a model-market approach. This market to model approach was what led to the fall of Enron, with the level of managerial discretion being able to cause large amounts of estimation errors and in some cases can lead to manipulation. The paper claims that the market to model approach creates a feedback loop in which the market values go up because firms have earnings, which they achieve because the markets are going up, so their assets get valued higher, and the cycle continues. Ceasa understands that this is oversimplifying the matter, but in effect we are moving this direction as a standard setting accounting society. They call for the income statement approach because this would reflect more the real economy activities of firms, and the use of checks on valuation for the financial trading markets. The long term result of leaving this problem feedback loop unchecked will allow for potential market bubbles to emerge because of the difference between the financial markets and the real economy.

VI. Summary of Critiques

Ceasa does not have all the answers to implementing the perfect conceptually fundamental basis for standard setting, and the four points listed are all merely areas in interest for future change in the accounting process. In order to provide some brief insight into this new fundamental framework the first major feature needed according to ceasa is a clear theoretical and practical distinction between operating and financing activities. They understand that there
will be controversy over the exact divide between operating and financing assets and liabilities, but in order to better reflect operational effectiveness of firms and have less focus on the valuation of assets for each firm. This controversy is nothing new for accounting, and the solution to these issues is at its basis the utility of accounting for financial users. This distinction between two activities needs to be reflected in all of the financial statements, and in order to have correct values for both regular operating activities and earnings due to market fluctuations we have to move away from a single bottom line. The costs of this according to ceasa out way the costs of continually mixing the two very different sources of income into a single bottom line, which as previously stated can reduce the usefulness of income and earnings in general. The other main institution that needs to be reintroduced to the framework is the concept of matching. As a governing body, FASB has moved away from this concept as it was not mentioned near the likes of other concepts in the preliminary views. It is argued that companies create value and are managed in the income statement mode, and the logic that in order to run a business you have to match costs with benefits. This basic fundamental shows that matching is at the core of most firms, and that needs to be reflected in the financial reporting accounting concepts. They conclude with the fact that if accounting wants to aim to faithfully reflect a business, its core business and drivers need to be reflected in financial reporting, i.e. matching.

VII. Essence of the Financial Statements

Initially I was really into the article and the thoughts it was provoking, but the more I think about it, I believe that earnings are really something to derived from assets and liabilities and the changes in those which result in gain or loss of equity. The article made me think way more about how important it is to have a distinction of operating and financing activities, but
when I do think about it I reach a different conclusion than the paper does. I came to think of it in terms of firms using all kinds of activities available to acquire new funding in order to put that forth to end up making revenue and creating expenses. I do believe that revenues and expenses are at the basis of many firms, and that this needs to be reflected in financial statements, but I want you to think deeper about just how the firm reaches that point. In my point of view, firms use both operational and financial assets in order to acquire many things, from deals, to partnerships, to vertical and horizontal acquisitions to increase efficiency, to simply just new equipment and machinery to operate their business. If you look at the situation in that way, it becomes clear that in essence the firm needs the assets and liabilities to be able to create any kind of revenue or expense, and that without the current complex system of constant valuation of all of these concepts, firms would be unable to acquire new things and use all their resources for liquid value as easily as they can right now.

**VIII. Positives of an Asset based approach**

To me what this paper is really getting at is the need for full disclosure and faithful representation. In my eyes that's what this paper was seeking to achieve through changes in the accounting for financial reporting. If you choose either the balance sheet-based approach or the income statement approach, you will have to have disclosure on things in order to people to understand how you got to that point. This article in a sense is arguing for the ability of firms’ operations to be better reflected in financial statements and more specifically earnings, but to me if you want to reach the same effect, than you just need to have a better way to disclose all displayed information and be able to prove the consistent faithful representation of those values. In order for users of financial statements to not have the stratification that is stated will occur in
the article, full disclosure would allow all investors, sophisticated or not, to have full insight into what those numbers actually mean. The simplification of the bottom line into different figures would not be useful in my opinion. The switch to that would just change values drastically around the economy and could have unforeseen costs and liabilities associated with it. With the level that all firms utilize financial assets, whether it be to make income, acquire new capital through trading, and even use them as cash equivalents in acquisitions of long term assets, balance sheet approach is best at showing the links between all these activities while keeping the values representative of what is going on both in the firm and in the markets.

IX. Going Forward

Going forward the information of this article will be able to constantly provide me with topics to think about in any accounting sense. This article went after some of the broadest subject areas in accounting, such as operating and financing activities, earnings usefulness, and even matching. This article will have the most effect on me when I am working with any firm that uses actual inventory and sales to create revenue, not a financial trading firm, or a service firm. The reason for this is that all the topics called forth in this article have a real pertinence to inventory, but to manufacturing especially. When you look at manufacturing as a business and read this article, a lot of what they state makes a good amount of sense, especially the concept of asset greenhouses vs asset furnaces. I think that is a very rudimentary way of stating it, but in effect it clearly communicates the vast differences in the American and the world economy. In order to be able to correctly link all the values across the whole economy, the balance sheet method comes right to the forefront of how to account for all the complexity. I think when you go company to company on an individual basis that income statement method and the thoughts
brought forward in this article would be very helpful for both consulting that firm and managing that firm.

If I were to be in a place in which a firm uses financial intangible assets in order to finance the purchase of their “asset furnaces” in order to produce the product that creates the main revenue stream of a company, the income statement method would really help me to get a better idea of just how well that firm is operating in their main market of business. So when talking to managers and employees I believe that this approach would be better for helping understanding between client and accountant. The issue arises when you have to talk to the executives and the financial people of the firm, because you cannot discount the management of their assets and liabilities, whether tangible or not. If they are constantly making bad investments and values drop which causes loses, this article would state that this does not truly represent the company, but to me this shows that while they can operate on the base line just fine if you take a step back you will see that the way they are able to operate effectively on the baseline is bad mismanagement of major assets and liabilities which allow them to make such profits at the manufacturing level. At the firm level thought one would be able to see how the effects of mismanagement actually affected the value of the firm while taking into effect the normal operations of the firm. The balance sheet approach allows one to see all of this, from the bottom to the top and brings the user of financial statements into more of full picture understanding of how the company is doing. To me the income statement method would incorrectly place important on regular operations of a company instead of company operations as a whole.

I think this article will make me think a lot more about the intangibles and the valuation methods each company uses in order to reach the amounts stated in financial reporting. I will be more into the fact of how those values are reached and the reliability of those values rather than
just the pure gain or loss resulting from the change in value. I think it is important for accountants to understand the income statement approach, as it is useful for communicating with clients, but the balance sheet approach takes a more whole hearted view and with the true efforts of full disclosure and faithful representation, would better represent the firm to the market and to other firms than the income statement approach.

X. What I learned

In terms of what I will most be thinking about now that I really did not before, is the matching principle. I always just assumed that matching was essential in accounting and in financial reporting, but this article brought that lack of matching as a function by FASB to my attention. I do believe that by matching to the best of our ability that all other concepts can be derived by this, but to me matching does not constitute the income statement approach. I firmly believe that with matching, a proper valuation must occur in order to know that you are matching correctly throughout the financial statements. The separation provided by the income statement approach would not be beneficial, in my eyes, to the real usefulness of matching. The beauty of matching is that it allows you to be able to sell inventory, realize gain on investments, and achieve gain or loss in values of long term assets all while being able to simultaneously be taking into account the true purpose of those items.
Case 12: Google Inc.

GAAP vs Non-GAAP Earnings

Prepared by: Ronald Bristol

5/1/19
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I. Summary

Earnings a really important product of the accounting system. This case offered us the chance to look at the differences between GAAP earnings and non-GAAP earnings, and the different financial measures that get us to those points. Non-GAAP financial measures are supplemental information that can be presented following the GAAP financial information. The case takes a delve into the specific differences that arise when you look at income from operations from GAAP and non-GAAP. There are 5 things that the case brings to our attention that are the reasons for the differences between the two reported numbers, and we have to figure out how the exclusion of those differences from non-GAAP income more correctly, in Google’s eyes, better represents the operations of Google. The final part of the case discusses the press release at the end of January in 2014, and how that affected Google as a company. The press release caused a growth in the stock market for Google, even though it still contained non-GAAP information. The non-GAAP information is discussed in the press release and it is up to the reader to determine why those differences were not in non-GAAP income. The growth in the stock market shows the public investors trust in the reported figures in the press release as the stock climbed after the release. The press release also contains other information that is useful in determining else helped cause the growth besides the strict revenue numbers determined. This case allows us to start at the beginning of the accounting process with discussing non-GAAP and GAAP and ends with discussing how press releases affect the stock market, or the final output of the accounting process. This brings the case full circle and always you to truly see the links between all of the statements and releases.
II. Use of Non-GAAP measures

Google uses many non-GAAP financial measures. Those include non-GAAP financial measures: non-GAAP operating income, non-GAAP operating margin, non-GAAP net income, non-GAAP EPS, free cash flow, and non-GAAP international revenues. In the press release accompanying the financial report, Google disclosed consolidated statements of income that were based off of non-GAAP measures. In order to arrive at non-GAAP statements of income, Google made 6 changes to accounting processes that account for the net income difference between GAAP and non-GAAP. The 5 changes that were made to establish a non-GAAP operating income and net income were as follows: 1. Eliminate stock-based compensation expense, 2. Eliminate restructuring and related charges, 3. Eliminate income tax effects related to stock-based compensation expense from (1), 4. Eliminate income tax effects related to restructuring and related charges from (2), 5. Eliminate net loss from discontinued operations. Google also defined how they reached operating margin as defined under GAAP and Non-GAAP respectively as follows, operating margin is defined as consolidated income from operations divided by consolidated revenues for GAAP and Non-GAAP operating margin is defined as non-GAAP consolidated income from operations divided by consolidated revenues for Non-GAAP calculation. I agree with these solutions to provide a better example of their company because Stock based compensation does not affect how they operate as a company, and is a recurring charge each year as a key performance metric reward for its employees. In terms of adding back in restructuring and related charges, I agree with this decision to better represent Google because this event does not significantly reflect the core business operation of Google. The related decision to change the income tax effects only makes sense because it would be
furthering the changes made for Stock Based Compensation and Restructuring charges in order to have the statement correctly reflect the changes made to transition to non-GAAP income.

III. Effect on Stock Prices

i. The stock price for the year of 2013 started at $707. Steadily throughout the year until right before the Q3 earnings were released the stock price was steadily rising, and when Q3 earnings were released the stock price shot up to a little over $1000 from just below $900. That huge jump is caused by positive earnings in the 3Q that were over what was expected. Then Google had a fantastic Q4 and was able to beat last year’s revenues by almost 1 billion dollars. They had 22 percent growth in revenues from 2012 and that caused the stock price to steadily be rising all of 2013, and making big jumps at releases of earnings in Q3 and Q4. At the release of Q4 earnings the stock price jumped up to around $1,200 and closed the year at a little just above that figure. The earnings performance in 2013 is very solidly correlated with the rise in stock price throughout the year.

ii. When you look at the NASDAQ prices throughout the year, that same steady growth that google shows is present, and the NASDAQ marker is almost matching Google until Q3 earnings release. The earnings release set Google stock price on a sudden rise that made Google’s growth be way faster than the NASDAQ’s. The price continued to stay on the similar slope as that of the NASDAQ, and then once again at Q4 earnings release Google’s stock price rose, and the NASDAQ stock price took a slight fall, showing that while the market might not have had an all-around solid Q4 earnings release, Google did. Google was growing steadily all year just like the companies represented in the NASDAQ, and when the earnings for Q3 and Q4 Google’s stock took a huge step up when the average company represented did not.
Google has stock prices around 1.1 thousand dollars close to the end of January. At the start of February, just after the press release on the 30th of January, the stock price rose from 1.1 thousand to almost 1.2 thousand to start February. That means that the earnings in the press release were good news to investors ears. They immediately started buying more google stock, as the price rose almost 10 percent from the end of January to the start of February. Shortly after February starts, the stock price dives down back closer to 1.15 thousand and starts to once again progress upwards for the remainder of February on the Google price history graph. This means that the earnings initially had people very excited, which caused the massive jump to bring the price on February 1st to almost 1.2k thousand. Then for a short period the stock price fell and stopped falling close to 1.15 thousand and started to climb up and was just at over 1.2 thousand at what looks like mid-February on the Google price history graph. The initial excitement over the press release must have died down fast and caused investors to worry for a couple days, and then the belief came back which allowed for the continual climb for the remainder of the price graph.

IV. How Google Maintained Growth.

i. For the fourth quarter of 2013, analysts had projected Google’s revenue to be $16.8 billion. The actual revenue for the fourth quarter was $16.9 billion which slightly beat the analyst’s projection of the company. This is a positive factor if you just look at the revenues for face value, but if you look deeper into why this occurred you will see why the investors liked this news so much. This $16.9 billion revenue number posted was driven by the 17 percent growth in the core advertising business of Google to $14.1 billion. Deeper inside of this ad growth, was the
fact that there was a 31 percent growth on clicks on company search advertisements. In total, the revenue posted for Q4 for 2013 was up 17 percent also from the prior year as well. All of these growth factors and the fact that the analyst’s projection was beaten caused mass excitement in the investing community. This resulted in a 2.6 percent growth during trading hours and then jumped up around 4 percent in the after-hours trading. Even the net income from 2013 of $2.89 billion rose to $3.38 billion in 2013. All of these factors positively correlated to the stock market reaction after the press release.

ii. Google’s shares have risen about 60 percent since the start of 2013, so one could say that with the switch to mobile browsing for most internet users has only helped to grow Google. Part of the reason for this is that Google had been improving the ads on phones. They have created new image-based ads that list items almost like you would find it on Amazon as a product listing, which has shown Google “great momentum” with this new ad type. Some of the success of these ads can be that they make it easier for users of Google to find and buy items on their phones, because the ads are more tailored for the bite size screens that are now being used instead of the computers. The only downside to this is that because of the smaller ad size companies are paying less for each click of the ad, which lead to an 11 percent drop in revenue per click. This negative aspect was turned over by the fact that Google was receiving a 31 percent increase in clicks on the advertisements. To further the good Google news, app sales on the Google play store lead to the “other” revenue line doubling to $1.7 billion. To become even more of a profitable company in 2014, Google also sold Motorola which had been making Google absorb over $2 billion in losses since 2012. The markets positive reaction can definitely be justified by all of the information above, but what really makes the future seem positive for Google is their investment levels. Google has capital expenditures of $7.4 billion for 2013 which
is up 125 percent from 2012. This along with the climb in cash balance and employee number shows the investor that Google is continuing to grow at solid rates and beat expectations of analysts.

V. What I learned

Non-GAAP measures can be pretty influential on a company’s stock. Google was able to obtain growth by issuing the press release that disclosed relevant information regarding the revenues, expenses, and the specific growth increases around the company. This shows that while all the concepts in accounting work for our profession, they are not always perfect in terms of representing a company’s operations. The fact that Google includes both kinds of income shows that investors still care about the true GAAP measures, but the insight gained from non-GAAP can be useful also. The stock market, which is the financial market in which google’s stocks and bonds are traded, gets affected by both earnings releases and press releases. I figured that investors would only truly care about what comes out each quarter in terms of earnings and financial statements, but the stock market graphs showed otherwise. The price of Google’s stock achieved growth when the press release came out, and none of that release was mandated by GAAP. The fact from this case that I really take away is that investors need to utilize all information companies release, as it all is relevant in determining the future operations of the company. Like for me, when I read the earnings release and saw that along with all the great revenue numbers, Google was making significant amount of Capital expenditures and acquiring new personal. This companied with the continual growth Google showed in the earnings reports would have really made me excited as an investor.
“On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this Thesis”
Signed __________ Ronald Howard Bristol III ______________