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An Examination of Accountancy Case Studies

Joshua Cathey

AN EXAMINATION OF ACCOUNTANCY CASE STUDIES

by

Joshua Cathey

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

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Approved by

Victoria Dickinson

Advisor: Professor Victoria Dickinson

W. Mark Wilder

Reader: Dean W. Mark Wilder

ABSTRACT

JOSHUA CATHEY: Compiled Studies of The Fundamentals of Financial Accounting

(Under the direction of Victoria Dickinson)

This thesis explores topics that are relevant to the profession of accounting, specific to the experience of a young professional in public accounting. Topics vary from exploration of tools used to analyze data, research into which city would be a good place to start a career, as well as relevant regulatory legal issues. The cases required a mixture of research as well as problem solving to obtain an understanding of the issues at hand. This research aided my ability to perform in front of accounting professionals at case studies that were hosted on campus. Through this research I decided on where I want to start my career, as well as which industry within accounting I would like to focus in. Upon conclusion of my research, I feel confident that public accounting is a good place to begin my career, and that I am prepared for what I will encounter in the professional world.

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Data Analytics Case

Josh Cathey

Accy 420

Dr. Dickinson

August 30, 2018

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

This case explores data analytics tools and how they are being used in the accounting profession. These tools allow companies to sort through large amounts of data and discover insights that were difficult to obtain before due to the volume of information. Data analytics is an important topic in the accounting world right now and will remain an important issue for firms to address. After reading documents from Splunk and outside sources, I have learned the numerous ways that data analytics tools can and have started to change the accounting profession. Many firms are searching to discover how the implementation of data analytics products can improve both the audit and tax services that they offer. Tools like Splunk can help firms greatly increase the efficiency of their operations. The aggregation of more data leads to better decision making and advice which are the main services accounting firms provide. The firms that get the best grasp on this concept are going to be better prepared for the future and able to provide higher quality advice. Firms that do not adequately understand this topic will fall behind and have to spend time to catch up.

During the research for this case I also learned more about how starting my career with knowledge of data analytics will be beneficial. Going into my job with additional knowledge of an emerging trend in the profession will surely be an advantage to me. Data analytics tools would help me have more informed insights for the clients I am working for and improve the efficiency of my work.

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

Splunk is a tool that is used to analyze data and aid in making decisions to improve the efficiency of a company. Through analysis of internal data within the company and monitoring outside trends, Splunk can help the company improve their operations. The name “Splunk” refers to how the software sorts through data the same way spelunkers search through unknown caves. With the aid of artificial intelligence, Splunk is able to collect data from different aspects and operations of the business and create results that provide information the business would not have known otherwise. Because Splunk offers options for both on-site or cloud storage of data, the company can cater to the security needs of a customer. The information and results that Splunk creates are viewable through a web interface for easy access from anywhere in the world. Companies also have the option of a desktop application that can be installed on Windows and MacOS operating systems.

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

Audit.

Splunk has many potential uses that would greatly improve both the accuracy and efficiency of an audit. One use case in an audit would be testing internal controls. Splunk allows users to analyze the access and use of their hardware throughout the company and test whether security controls are functioning properly. Splunk utilizes machine log analysis to track the activity of specific devices throughout the company to ensure security.

A second use case would be that Splunk would reduce the time auditors spend hunting through documents and taking random samples. By uploading all of the relevant documents and data, auditors can analyze all transactions. Additionally, auditors can find specific transactions through the search tool in Splunk. This allows for more extensive and thorough testing to be conducted and ensures the verity of the results.

A third use case for Splunk in auditing is recognizing patterns. The software is capable of recognizing patterns in financial transactions that would take significant amounts of time in a traditional audit. By searching through all of the data with specific parameters, auditors are capable of noticing trends that would have gone unforeseen without the tool.

Tax.

Splunk also has uses that would benefit tax planning. One use case involves the aggregation of data. Companies that have operations in multiple countries have to take into account the different tax laws of each nation. Splunk allows the company to plan where revenue should be received and recognized to reduce the amount of taxes paid by analyzing tax regulation in different markets. With Splunk, tax accountants could calculate what regions are the most profitable and predict trends in taxation for future periods.

A second scenario where Splunk would be beneficial to tax accountants is to determine future locations for expansion and product development. By using the information provided about the tax environment in different markets, companies can visualize what markets are the most lucrative and would be the most beneficial for their company. The same process can be performed to analyze products. Analysis of parts suppliers and the relevant taxes for each product, trends and anomalies are realized before it develops to a more urgent matter.

A third case where Splunk would be useful to tax accountants is transfer pricing. Data collected by Splunk could be used to determine what the best cost to be used in each scenario would be. A cost that is supported by data would be beneficial to a company for their internal records and when reviewed by an outside source.

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

To: Mr. Chad Walker, CPA

From: Josh Cathey

Date: August 30^{th}, 2018

Re: Utilizing Data Analytics

Utilizing Splunk and the information it provides would result in improvements in each area of services that the firm provides. Splunk offers multiple ways to increase the accuracy and reliability of the information used in the decision-making process through its data collection tools. Using this data, the firm can improve and refine the guidance that it provides to clients. By taking the time to implement Splunk into audit teams and tax planning, the services the firm offers the client would be worth more and therefore could lead to more revenue for the firm.

For the audit practice, Splunk provides the capability to quickly and effectively test the internal controls of the business through data collected from hardware around the company. Splunk also provides the key advantage of being able to analyze all revenue related transactions for the company instead of having to select only a fraction of the business' transactions to review. This results in the ability to recognize trends and patterns that would not have been revealed without analysis of all relevant transactions. Splunk would greatly improve the ability of the audit team to be sure that all aspects of the business have been thoroughly examined and tested.

Splunk would also be beneficial for the tax planning services provided by the firm. Using the provided data aggregation tools, the structuring of the company to most effectively deal with different tax regulations in various markets can be planned. Additionally, through the data aggregation the tax planners would be able to see which products are performing the best and map out how the company should expand to most effectively increase revenue. Splunk would also be beneficial for calculating transfer pricing to ensure the company reaches a fair price that is backed up by unbiased data.

The implementation of Splunk is not projected to have a substantial impact on staffing for the firm. Some staff or associate positions might become less necessary, but those employees could be retrained to use Splunk and help provide further insight into the results provided. Splunk provides training through their website as well as trainers that can meet in person with staff from the firm to show how to most effectively use the program. Splunk is not meant to displace current staff positions, instead it improves the quality of analysis and confidence of decision making for the firm. The choice to incorporate Splunk into the operations of the business will provide clear benefits and result in few negative consequences.

Rocky Mountain Chocolate Factory

Josh Cathey

Accy 420

Dr. Dickinson

September 6, 2018

A. On the balance sheet I expect to see accounts that illustrate a moment in time, such as Cash, Accounts Receivable, Short Term Investments, Equipment, Trademark. Major liabilities should include short term and long term liabilities such as Accounts Payable, Notes Payable, Interest Payable.

E. Might need to adjust PPE for depreciation, reduce inventory based on ending amount and acrrue earned but unpaid wages.

K.

1- operating
2- operating
3- operating
4- operating
5- operating
6- operating
7- operating
8- operating
9- investing
10- financing
11- unknown
12- operating
13- operating
14- operating
15- none

Introduction

This case instructed us to go through a company's financial records and prepare financial statements. I had to prepare journal entries, examine the balance sheet, post entries, prepare trial balances and making adjusting entries. This case provided real experience working with an actual company's financial records. At the end of the case I felt very familiar with Rocky Mountain Chocolate Factory's financial statements.

Summary of what I learned

This case helped me learn more about Microsoft Excel. I have used Excel before but figuring out how references work between sheets and adjusting the print area was new for me. I am familiar with the accounting cycle but I have not performed these actions on a compute before. In all of my accounting classes we have done the work by hand so it was nice to be able to complete some of the tasks in a swift manner. I now have a template for preparing future financial statements that is properly referenced throughout the whole workbook to ensure I do not make transposition errors.

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

	Beginning balance (February 28, 2009)	1. Purchase Inventory	2. Incur Factory Wages	3. Sell inventory for cash on accout	4. Pay for inventory	5. Collect receivables	6. Incur SG&A (cash and payable)	7. Pay wages	8. Receive franchise fee	9. Purchase PPE	10. Dividends declared and paid	11. All other transactions
Cash and cash equivalents	$ 1,253,947.00			$ 17,000,000.00	$(8,200,000.00)	$ 4,100,000.00	$(2,000,000.00)	$(6,423,789.00)	$125,000.00	$(498,832.00)	$(2,403,458.00)	$ 790,224.00
Accounts receivable	$ 4,229,733.00			$ 5,000,000.00		$(4,100,000.00)						$ (702,207.00)
Notes receivable, current	$ -											$ 91,059.00
Inventories	$ 4,064,611.00	$ 7,500,000.00	$ 6,000,000.00	$ (14,000,000.00)								$ (66,328.00)
Deferred income taxes	$ 369,197.00											$ 92,052.00
Other	$ 224,378.00											$ (4,215.00)
Property and Equipment, Net	$ 5,253,598.00									$ 498,832.00		$ 132,859.00
Notes receivable, less current portion	$ 124,452.00											$ 139,198.00
Goodwill, net	$ 1,046,944.00											
Intangible assets, net	$ 183,135.00											$ (73,110.00)
Other	$ 91,057.00											$ (3,007.00)
Accounts payable	$ 1,074,643.00	$ 7,500,000.00			$(8,200,000.00)							$ 503,189.00
Accrued salaries and wages	$ 423,789.00		$ 6,000,000.00					$(6,423,789.00)				
Other accrued expenses	$ 531,941.00						$ 3,300,000.00					$ (2,885,413.00)
Dividend payable	$ 598,986.00										$ 3,709.00	$ (1.00)
Deferred income	$ 142,000.00								$125,000.00			$ (46,062.00)
Deferred income taxes	$ 827,700.00											$ 66,729.00
Common stock	$ 179,696.00											$ 1,112.00
Additional paid-in capital	$ 7,311,280.00											$ 315,322.00
Retained earnings	$ 5,751,017.00										$(2,407,167.00)	
Sales	$ -			$ 22,000,000.00								$ 944,017.00
Franchise and royalty fees	$ -											$ 5,492,531.00
Cost of sales	$ -			$ 14,000,000.00								$ 693,786.00
Franchise costs	$ -											$ 1,499,477.00
Sales & marketing	$ -						$ 1,505,431.00					
General and administrative	$ -						$ 2,044,569.00					$ (261,622.00)
Retail operating	$ -						$ 1,750,000.00					
Depreciation and amortization	$ -											
Interest income	$ -											$ (27,210.00)
Income tax expense	$ -											$ 2,090,468.00

Unadjusted Trial Balance	12. Adjust for inventory count	13. Record depreciation	14. Wage accrual	15. Consultant's report	Pre-closing trial balance	16. Closing entry	Post-closing (ending) balance	Actual February 28,2010 F/S Figures
$ 3,743,092.00					$ 3,743,092.00		$ 3,743,092.00	
$ 4,427,526.00					$ 4,427,526.00		$ 4,427,526.00	
$ 91,059.00					$ 91,059.00		$ 91,059.00	
$ 3,498,283.00	$(216,836.00)				$ 3,281,447.00		$ 3,281,447.00	
$ 461,249.00					$ 461,249.00		$ 461,249.00	
$ 220,163.00					$ 220,163.00		$ 220,163.00	
$ 5,885,289.00		$(698,580.00)			$ 5,186,709.00		$ 5,186,709.00	
$ 263,650.00					$ 263,650.00		$ 263,650.00	
$ 1,046,944.00					$ 1,046,944.00		$ 1,046,944.00	
$ 110,025.00					$ 110,025.00		$ 110,025.00	
$ 88,050.00					$ 88,050.00		$ 88,050.00	
$ 877,832.00					$ 877,832.00		$ 877,832.00	
$ -			$646,156.00		$ 646,156.00		$ 646,156.00	
$ 946,528.00					$ 946,528.00		$ 946,528.00	
$ 602,694.00					$ 602,694.00		$ 602,694.00	
$ 220,938.00					$ 220,938.00		$ 220,938.00	
$ 894,429.00					$ 894,429.00		$ 894,429.00	
$ 180,808.00					$ 180,808.00		$ 180,808.00	
$ 7,626,602.00					$ 7,626,602.00		$ 7,626,602.00	
$ 3,343,850.00					$ 3,343,850.00	$ 3,580,077.00	$ 6,923,927.00	
$ 22,944,017.00					$22,944,017.00	$(22,944,017.00)	$ -	
$ 5,492,531.00					$ 5,492,531.00	$ (5,492,531.00)	$ -	
$ 14,693,786.00	$ 216,836.00				$14,910,622.00	$(14,910,622.00)	$ -	
$ 1,499,477.00					$ 1,499,477.00	$ (1,499,477.00)	$ -	
$ 1,505,431.00					$ 1,505,431.00	$ (1,505,431.00)	$ -	
$ 1,782,947.00			$639,200.00		$ 2,422,147.00	$ (2,422,147.00)	$ -	
$ 1,750,000.00			$ 6,956.00		$ 1,756,956.00	$ (1,756,956.00)	$ -	
$ -		$ 698,580.00			$ 698,580.00	$ (698,580.00)	$ -	
$ (27,210.00)					$ (27,210.00)	$ 27,210.00	$ -	
$ 2,090,468.00					$ 2,090,468.00	$ (2,090,468.00)	$ -	

Revenues				
	Sales		$ 22,944,017.00	
	Franchise and royalty fees		$ 5,492,531.00	
	Total revenues			$ 28,436,548.00
Costs and Expenses				
	Cost of sales		$ 14,910,622.00	
	Franchise costs		$ 1,499,477.00	
	Sales & marketing		$ 1,505,431.00	
	General and administrative		$ 2,422,147.00	
	Retail operating		$ 1,756,956.00	
	Depreciation and amortization		$ 698,580.00	
	Total costs and expenses			$ 22,793,213.00
Operating income				$ 5,643,335.00
Other Income (Expense)				
	Interest income		$ 27,210.00	
Income before income tax				$ 5,670,545.00
Income tax expense			$ 2,090,468.00	
Net Income				$ 3,580,077.00
Base Earnings per share				$ 0.60
Shares Outstanding		5989858		

Assets				
Current Assets				
Cash and cash equivalents		$ 3,743,092.00		
Accounts receivable		$ 4,427,526.00		
Notes receivable, current		$ 91,059.00		
Inventories		$ 3,281,447.00		
Deferrered income taxes		$ 461,249.00		
Other		$ 220,163.00		
Total Current Assets			$ 12,224,536.00	
PPE Net			$ 5,186,709.00	
Other Assets				
Notes receivable, less current portion		$ 263,650.00		
Goodwill, net		$ 1,046,944.00		
Intangible assets, net		$ 110,025.00		
Other		$ 88,050.00		
Total other assets			$ 1,508,669.00	
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	
Commitments and Contingencies				
Stockholder' 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

1- operating
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4- operating
5- operating
6- operating
7- operating
8- operating
9- investing
10- financing
11- unknown
12- operating
13- operating
14- operating
15- none

1	Inventory				$ 7,500,000.00	
		Accounts Payable				$ 7,500,000.00
2	Inventory				$ 6,000,000.00	
		Wage Payable				$ 6,000,000.00
3	Cash				$ 17,000,000.00	
	Accounts Receivable				$ 5,000,000.00	
		Sales Revenue				$ 22,000,000.00
	Cost of Goods Sold				$ 14,000,000.00	
		Inventory				$ 14,000,000.00
4	Accounts Payable				$ 8,200,000.00	
		Cash				$ 8,200,000.00
5	Cash				$ 4,100,000.00	
		Accounts Receivable				$ 4,100,000.00
6	Sales & Marketing Expenses				$ 1,505,431.00	
	General & Administrative Expenses				$ 2,044,569.00	
	Retail Operating Expenses				$ 1,750,000.00	
		Cash				$ 2,000,000.00
		Accounts Payable				$ 3,300,000.00
7	Wage Payable				$ 6,423,789.00	
		Cash				$6,423,789.00
8	Cash				$ 125,000.00	
		Unearned Income				$ 125,000.00
9	PP&E				$ 498,823.00	
		Cash				$ 498,823.00
10	Dividends Declared				$ 2,407,167.00	
		Dividends Payable				$ 3,709.00
		Cash				$ 2,403,458.00

12	Cost of Goods Sold		216836	
		Inventory		216836
13	Depr Exp		698580	
		Acc Depr-PPE		698580
14	Gen & Admin Exp		639200	
	Retail Operating Exp		6956	
		Wages Payable		646156
15	NO ENTRY			

Situation Analysis Case 3

Josh Cathey

Accy 420

Dr. Dickinson

September 12, 2018

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Executive Summary

This case analyzes various situations that accounting students face and discusses the different options and paths that are available. In class the situations were read out loud and we were instructed to move to different sides of the room based on which side of the story we agreed the most with. After everyone moved around the room, the merits and flaws of each side of the situation were discussed. Through dialogue with other students I was able to learn a lot about some areas of the accounting profession I did not know about as well as possible career paths. For example, I was not aware that it was common for students to earn an accounting degree and then have a desire to go to law school. I have known that an accounting degree provides good opportunities to get involved with other business careers, but I have not spent much time researching what those careers are. From this case I was able to learn more about law and investing career paths.

Each person in the class brings unique knowledge and experience that is beneficial to be shared with others in the class. Sometimes we don't talk about uncertainties with our peers because we all want to seem put together and that we have it all figured out when the reality is most of us still have a lot of learning to do before we make important decisions. During the class I realized that I have not explored what other options are available to me besides completing the traditional five-year degree and going right into public accounting. I am interested in learning more about these other options that I now know are a possibility. The time is rapidly approaching where I will have to make decisions about where I want to do my internship and start my career, so I will have to figure out the path I want to go down.

Situation 1

In this case, a student named Eric told a friend that he was contemplating going to law school because of the earnings potential for people with a law degree in the tax field of public accounting. His friend pointed out that going to law school requires a significant investment of time and money compared to completing a traditional accounting degree and going into tax. Eric was determined that going to law school would be a better choice for his career. After this presentation the class was opened to discussion. I was not convinced that going to law school and then into tax would be a good idea. It seemed to me that if his motivation was purely to make as much money as possible that he should go to law school and become a lawyer instead of going into the tax field. Investing additional years in school when there is not a long-term change in earnings potential would not be a choice I would make. I learned from the class discussion that while the starting salary in the tax field for those with law degrees is higher, over time those with just a tax degree will catch up. Some people in the class made the point that if his goal was to make money that getting a tax degree would put him in a job earlier and he would not incur the costs of law school. If I were Eric I would not go into tax. If his goal is to make as much money as possible, he has other options that would earn more money. If his desire is to be in tax, I do not think law school is the best choice. The long-term difference in earnings does not seem to be significant and it would require a substantial investment of time and money.

Situation 2

In the second scenario, a student was telling some friends about how he wanted to get into investment banking. They were trying to decide if accounting would be a good major for someone who has a desire to do something besides accounting. The options of finance or banking majors were discussed. After a few more lines back and forth the topic was presented to the class about whether we thought accounting would be a good major for people who might want to have a career in something other than accounting. I chose the side that said the student should remain in accounting. As Dr. Cantrell told me in Principles, “accounting is the language of business”. I believe that an education and background in accounting would provide the student with solid experience and knowledge in many different aspects of business. Instead of narrowing down your potential choices by choosing a more specific major, accounting opens many possibilities for career exploration. In addition to this, the business school at Ole Miss is not nearly as respected as the Patterson School. Starting your career with a firm understanding of the functions of business from a prestigious school seems to be a good place to start to me. Some people in the class debated whether it was ethical to be major in accounting if you know accounting is not what you want to do. Others pointed out that the spot you take in the school could have been filled by another student who had a desire to be an accountant. I was not particularly convinced by this argument because there is not a cap on how many people can be accounting majors. If a student has a desire and the work ethic, they can choose to be an accounting major.

Situation 3

The final situation presented to the class was an email exchange between a former student and Dr. Dickinson. The student had completed his internship with a firm in Washington, D.C. and was hoping to transfer his offer to his hometown of Dallas, Texas. He was unsure of how to go about telling his superiors in the firm about his desire to change location and was looking to Dr. Dickinson for guidance. For some reason this issue seemed to really divide the class. Some people were convinced that it was very wrong of the student to try and transfer his offer. These students claimed that it was pointless to build relationships in an office if you did not have a desire to stay there and that it would hurt his career with the firm if he tried to move locations. I thought it was hard to pass judgement on him without knowing all the circumstances behind his decision to try and transfer locations. As a student who is a long way from home and family, I can sympathize with someone who desires the comfort and familiarity of home. However, I think it is important to put yourself outside of your comfort zone to be able to grow both personally and professionally. Some also claimed that it was silly of this student to reach out to his professor about his situation. I thought that was a foolish claim. Seeking guidance from someone who has more experience than you never seems like a bad idea to me. I will add that my answer might be biased by the fact that my father is an accounting professor and I have heard him tell many stories about how excited he is when students come to him looking for assistance. The student received a reply that explained that the Dallas office is very competitive and that it might be respectful to the firm to start in DC and see how things go. If he performs well after a couple of years, a transfer to a different office would be a possibility that would not ruffle as many feathers and be a smoother process. Being transparent with firms is important so your superiors are on the same page as you are about what your intentions and desires for your career are.

I believe that the student should really think about what is important to him and make the decision that is best for him. Life is too short to make decisions only considering money and careers. However, it is also important to not be short-sighted when making important decisions. If he is open to giving DC a try, I think the best choice would be to give it a try. If he can make it a couple of years and still wants to go back home that is a possibility, but he might also find that it just took more time to get used to being in a new place.

Debt Securities Sales and Impairments Case

Josh Cathey

Accy 420

Dr. Dickinson

October 3, 2018

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Executive Summary

This case created a scenario where a bank is trying to determine what to do with securities that it holds. Through different situations such as needing to raise liquidity and wanting to reduce risky assets I had to determine justifiable actions for the bank. The information in the case prompted me to research Accounting Standards Updates, FDIC Regulations, Office of Thrift Supervision Handbooks and guidance provided by different accounting firms related to the presented topic. From my reading I learned about recognition principles related to debt securities as well as ratios that are relevant to banks. I also learned about what aspects of a bank's operations different outside groups would examine. I had not heard of a CAMELS rating before this case and I also found the differences between the examination of an auditor and a bank regulator to be fascinating. From this research I was able to determine what an appropriate course of action for the bank would be. It was my first time directly reading accounting standards and I believe I would enjoy doing work such as this in my professional career.

I enjoyed how this case did not have one correct answer. In my accounting classes so far, there has been only one right answer for every problem, so I liked the challenge that this case provided. The documentation I researched provided information that could support multiple different decisions about the proper actions by the bank. Having to conduct research to support my answer caused me to realize that many times in my career I will be faced with situations such as this one where there is no textbook that provides the correct answer or route for the company. The sources I examined and my prior knowledge from accounting courses helped me to construct an argument for justifiable and supportable actions for the bank in each scenario.

1. **Does Generic Bank have an impairment loss on the seven securities designated above in 20x2?**

Generic Bank has an impairment loss on five of the seven designated securities. On two of the securities there is a gain. For five of the bonds the fair value is less than the amortized book value, therefore the security is impaired, and a loss should be recognized if the securities are sold.[1] The loss of $54.209 million is currently in Accumulated Other Comprehensive Income and should be recognized in the financial statements. The transaction happened in 20x3, but the decision to sell the securities was made in 20x2 and the securities were sold soon after the balance sheet date.[2] Additionally the case states that "if the bank is not able to assert that it has the intent and ability to hold the securities until unrealized losses have recovered, then the securities would be deemed impaired and written down to their fair value". Therefore, when the Bank decided to sell the securities in 20x2, they sacrificed the intent to hold the securities until they could recover the impairment.[3] The culmination of this evidence concludes that the loss should be recognized in 20x2.

2. **Does Generic Bank have an impairment on securities other than the seven securities sold? If so how would you determine the extent of the impairment?**

There will be no impairment recognized for the securities that are not sold. According to the ASU, if the impairment is determined to be caused by something other than a credit loss and the firm has the intention to hold the securities until they recover their value, the impairment does not need to be

[1] ASC 326-30-35-1

[2] Yrudek. "IAS plus." Financial Reporting Alert 13-2, Accounting for Impaired Debt Securities. August 19, 2013. Accessed November 05, 2018. https://www.iasplus.com/en/publications/us/financial-reporting-alerts/2013/fra-13-2.

[3] ASC 326-30-35-10

recognized.[4] The bank claims that it "has the intent to hold the securities until they mature or the unrealized losses recover." Therefore, no impairment for the securities other than the ones sold will be recognized. The case also states that the bank has other options such as FHLB advances and Fed Funds for raising liquidity. If the bank did not have these options, it would be prudent to recognize the impairment because it is likely that the bank will need liquidity at some point before the bonds recover their value. This would comply with official guidance from the Office of Thrift Supervision.[5]

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

My answer would not change based on the available facts. Generic Bank is "well capitalized" meaning they have met the FDIC requirements for capital ratios.[6] Selling the securities does not put Generic Bank in a position that would compromise their financial standing regarding the required ratios.[7] Auditors can check the financial statements of Generic Bank and find that the company still meets the required levels and ratios.[8] Auditors might also check with the bank to ensure their intentions to hold the securities. Bank regulators would examine factors other than liquidity such as the current financial state of the bank and

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[4] ASC 326-30-35-10

[5] Office of Thrift and Supervision Handbook Section 540- Liquidity

[6] FDIC Insurance Risk Guidelines

[7] FDIC Safety Manual- Section 2-1

[8] ASC 320-10-35-34B

compliance with regulations. Bank regulators would also assess the bank's CAMELS rating which analyzes different components of the bank's operations (including liquidity).[9] Auditors and regulators might attempt to determine how long the impairment recovery would take and estimate based on projected cash flows if the bank will have liquidity issues and potentially need to sell the securities before the impairment is recovered.[10] Due to the stable financial condition and availability of capital to the company, it is reasonable to believe that Generic Bank has the intent and ability to hold the securities until they recover the impaired value.

4. **How would your assessment of the existence of an impairment in both requirements change if the securities sold had been collectively in a net gain position? What if all the securities sold were in a gain position?**

There would not be an impairment because the definition of an impairment for a debt security is "if the fair value of the investment is less than its amortized cost basis."[11] If all of the securities sold had collectively been in a gain position but all of the other securities the bank held were in a net loss position, that would not be an honest tactic by the bank and not provide a faithful representation of their economic situation. The bank should not cherry pick securities to sell that would make the other securities held look more favorable than they actually are. The bank may also be tempted to include the gain on securities sold in net income, but this would also be dishonest if the other

[9] FDIC Safety Manual- Part 2

[10] "Background." Accounting for Impaired Debt Securities. Accessed September 30, 2018. https://dart.deloitte.com/USDART/resource/1dec86a3-3f81-11e6-95db-89638db2f848.

[11] ASC 326-30-35-1

securities that it holds are in a loss position. Generic Bank should not choose to sell securities that are not indicative of the standing of other securities that it holds.

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

The FDIC states that if a bank is "adequately capitalized" that it is, "Not Well Capitalized and Total Risk-Based Capital Ratio equal to or greater than 8 percent, and Tier 1 Risk-Based Capital Ratio equal to or greater than 4 percent, and Tier 1 Leverage Capital Ratio equal to or greater than 4 percent."[12] This classification would prompt the bank to take actions that would reduce the amount of risky assets the bank has in order increase liquidity and decrease risk. If the bank decides that selling securities is the best way to reach their goal of becoming well capitalized, certain measures will have to be taken to ensure that the financial reports of the bank accurately represent the current standing of the company. Generic Bank does have an impairment loss on the securities other than the ones sold, but it does not necessarily need to currently recognize the loss on all of the securities. The ASU states, "A reporting entity should recognize the impairment when it has the intention to sell the security or it is more likely than not that the reporting entity will be required to sell the security before recovery of the amortized cost basis."[13] The bank should examine its future cash flows and make an assessment of the likelihood that certain securities will have to be sold. The impairment on securities that the bank deems likely to be sold should be

[12] FDIC Insurance Risk Guidelines

[13] ASC 326-30-35-10

recognized in the current period. If the bank determines that certain securities are not likely to be sold before they recover their value, the impairment on those securities does not need to be recognized.

City Selection Case

Josh Cathey

Accy 420

Dr. Dickinson

November 7, 2018

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Executive Summary

In this case I had to gather information and research the cities I am considering living in. I am glad to have the opportunity to do this case because each of the questions are important factors to consider when moving to a city and there were some of them that I had not thought of before. The first city I researched was Charlotte, North Carolina. I am from Charlotte and lived there up until I started school at Ole Miss. I already knew some of the information for the case, but there was also some that I had to research. Before taking this course, I did not know that Charlotte was one of the three largest cities in the southeast for accounting firms. I have heard from multiple firms that their Charlotte office is a great place to start a career and I am now more confident that it is the place for me to be.

The other city that I researched was Birmingham, Alabama. Two of my best friends at school as well as my girlfriend are from Birmingham, so I have spent a good amount of time there and learned some about the city. I had to do a lot more research for this city and was interested in what I found. I did not realize that banking and health care are popular industries in the city which provide a large amount of accounting jobs. I also did not know how popular mountain biking is in the Birmingham area which was nice because that is one of my favorite things to do.

Overall, I learned a lot about Charlotte and Birmingham from both a professional and personal interest level. I now feel more prepared to make a decision about which city I want to start my career and spend a few years living in after I graduate from Ole Miss.

Charlotte, NC

1. What is the population?
   a. The population of the Charlotte metro area is roughly 2.5 million people, according to Census estimates from 2017.[14] It is a region that is experiencing a lot of growth. Charlotte is the fourth fastest growing city in the United States and shows no sign of slowing down soon.[15]
2. Describe the city climate and seasonal fluctuations.
   a. The climate of Charlotte is very similar to Oxford. The main difference would be that the summers are less humid. The average rainfall is lower than Oxford and there is at time snow in the winter. Overall the two regions are very similar. One of my favorite things about Charlotte is that you really do experience all four seasons.
3. Describe the city's topography, scenery and other geographic or geological features of the area in which the city is located. Include pictures where appropriate.

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[14] US Census Bureau. "Population and Housing Unit Estimates Tables." Tables. June 08, 2018. Accessed November 05, 2018. https://www.census.gov/programs-surveys/popest/data/tables.html.

[15] "Charlotte - 3rd Fastest Growing Big City in United States - Charlotte Chamber." Charlotte Chamber. Accessed November 05, 2018. https://charlottechamber.com/blog/2018/05/24/data/charlotte-3rd-fastest-growing-big-city-in-united-states/.

a. Charlotte is in an area of North Carolina known as the Piedmont. It is a relatively flat part of the state located just east of the Appalachian Mountains. I really enjoy how easy it is to get to the mountains from Charlotte. You can be in a big city and hop in the car and in a little over an hour you are lost on a mountain road. The Blue Ridge Parkway is only a 90-minute drive from most parts of Charlotte and that is my favorite place in the world. Shown below is a picture I took just outside Blowing Rock on the BRP. As far as the actual city of Charlotte goes, the topography is mainly flat. The downtown area of Charlotte is called Uptown because it is built on a small hill, but it is not very noticeable.

4. What are the individual tax rates in the city? Quantify what this means based on a starting salary of $50,000 per year.

    a. North Carolina has a flat tax on individual income of 5.5 percent. After factoring in other applicable taxes, my income would be roughly $39,500.[16] This is a lot lower than other big metropolitan cities, but it is higher than some other areas like Texas that do not have a state income tax.

5. What transportation hubs are in the city?

    a. Charlotte is home to the Charlotte-Douglas International Airport which is the sixth largest airport in the United States. It is the second largest hub for American Airlines behind Dallas. I have never had a connection on any

[16] "North Carolina Department of Revenue." NCDOR. February 16, 2018. Accessed November 05, 2018. https://www.ncdor.gov/taxes-forms/individual-income-tax.

flight that I have been on from Charlotte so that has been nice. Charlotte also has CATS (Charlotte Area Transportation Services). CATS provides bus, train and light rail services. I have used the bus and light rail to get to work before and have been very pleased with my experiences.

6. What is the city's most prevalent industries?
    a. Banking is by far the largest industry in Charlotte followed by energy. Bank of America and Duke Energy are the largest employers and are very important in the region. With the banking industry there are a lot of other financial industries that are in the city. Investment banks are starting to open offices in Charlotte for the proximity to Bank of America. There are eight Fortune 500 companies as well as seven Fortune 1000 companies that are headquartered in the Charlotte area.
7. Describe the quality of the city's healthcare?
    a. Carolinas Healthcare and Novant Health are the two main healthcare providers in the area. Interestingly, Charlotte is the largest city in the US that does not have a medical school.[17] Healthcare is probably not on par with other cities, but I never had a problem with it growing up. Some of my friends that have had more serious medical problems have gone to Durham for the Duke healthcare system.
8. What types of crime are common in the city and where are locations in the city to avoid?

[17] "5 Things to Know about Charlotte's Health Care Scene." Accessed November 05, 2018. https://www.charlotteobserver.com/living/living-here-guide/article99179362.html.

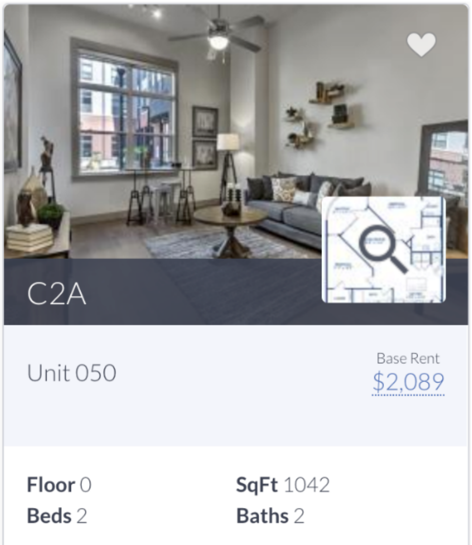
a. Burglary, vehicle theft and assault were the most common crimes reported in Charlotte in 2017.[18] There were also 85 homicides. This is more common in the east and west parts of Charlotte. Historically, these are the parts of the city populated by minority communities that were pushed out of south Charlotte through processes such as redlining. Uptown, south Charlotte and the suburbs on the northern side of the city are the safest parts of the city to live. My grandmother lives in the east part of the city and has been a victim of crime on multiple occasions. I would have no reason to visit these parts of the city.

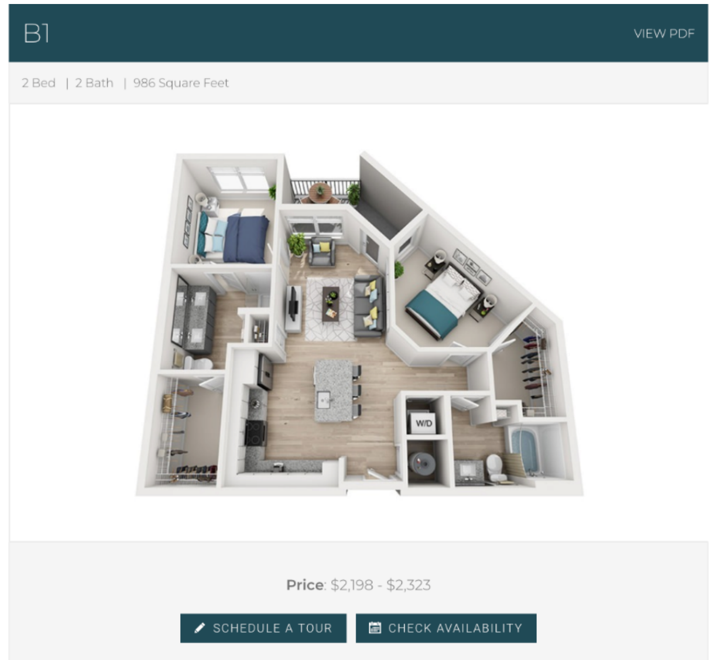
9. Based on where you see yourself living for the first three years, how much rent do you expect to pay?

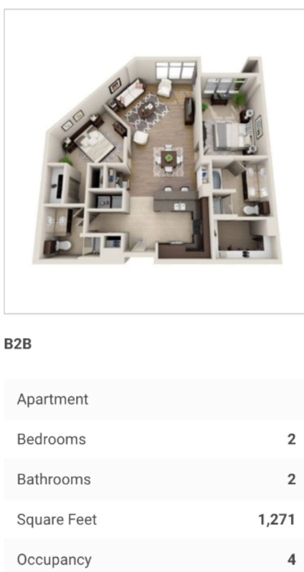
    a. I would like to live in South End when I am a young adult. This is a part of city just outside of Uptown which is where I would be working. The city built a light rail that travels between South End and Uptown that would make getting to work very easily. Apartment buildings are popping up in South End and the excess of supply has caused prices to drop recently. I would like to live with at least one roommate to reduce the amount of rent that I would be paying. Based on averages I believe I would be paying between $1,000 and $1,200 each month in rent. There are cheaper places that I could live but I want to live near other young people and I do not want to spend hours of my day commuting. All of the

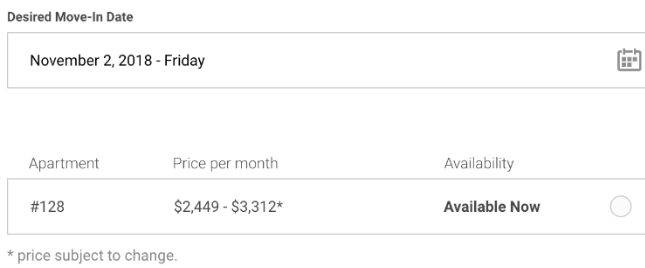
[18] "For Your Safety." Accessed November 05, 2018. https://charlottenc.gov/CMPD/Safety/Pages/CrimeStats.aspx.

apartments I looked at had parking available for residents at no extra charge.









10. What is the typical mode of commuting? Based on your answers identified in the prior question, what are the commute times?

    a. I would most likely commute by light rail if I am going to the office of the firm. All of the big four firms have offices in Uptown. This would take me about ten minutes to get from my apartment to the office. If I am working at a client's office I would have to drive myself there. The commute to the office would be very short which is one of the main reasons I would like to live in South End. I would not see myself spending more than fifteen minutes getting to work in the downtown area.

11. Where will you do grocery shopping?
    a. There are Whole Foods and Harris Teeter locations in South End that I would most likely frequent. I could carry the groceries back to my apartment or drive my car. South End is very walkable, but it might be inconvenient to walk around with a lot of groceries.
12. How will you do your laundry?
    a. All the apartment communities that I have looked have washers and dryers in the apartment. This would be the simplest and easiest way to get all my laundry done. Worst case I could drive to my parent's house and do it there.
13. Name at least three civic, religious or charitable activities you would like to be active in?
    a. I grew up in Lake Forest Church and I am looking forward to hopefully becoming a member if I end up in Charlotte after I graduate. I would also like to get more involved in the Tarheel Trailblazers. They are an organization that builds and maintains mountain bike trails in the Charlotte area. Additionally, my church works with an organization called Christmas Village Toy Store that partners with low-income neighborhoods around Charlotte and provides parents the opportunity to purchase Christmas presents for their children at discounted prices. I have enjoyed

volunteering with this organization in the past and hope to be involved in the future.

14. What are the sports, entertainment or recreational activities that you would like to engage in within the city?
    a. The Tarheel Trailblazers have multiple trail networks around the city and I would like to get out and ride my bike on them at least one time each week. Each Wednesday night the Bechler art museum in Uptown has free exhibits and I have enjoyed going to that in the past. I would also like to see a few Carolina Panthers football games. The Charlotte Knights are a minor league baseball team that has $5 games on some nights in the summer that I would enjoy going to. Additionally, my church hosts a fitness Bible study for adult men that I would like to be involved in.
15. What are your modes of traveling back to your hometown from this city? What is the average cost you would incur for each trip back home?
    a. I am from Charlotte, so I would not have to travel very far to see my family. As a young professional I would most likely be living in the city and my family lives out in the suburbs. The cost for each trip back home would be whatever the nominal fuel cost is between my apartment and home.
16. Based on your findings, develop a model monthly operating budget for each city for Year 2, assuming annual salary is $60,000.
    a. Based on my estimated income, I would expect my monthly budget to look something like this:

Rent	$1,100
Tithe	$380
Saving	$1160
Food	$500
Fun	$500
Misc	$200
Total	**$3,840**

Your Income Taxes Breakdown

Tax Type	Marginal Tax Rate	Effective Tax Rate	2017 Taxes	2018 Trump Taxes*
Federal	25.00%	13.56%	$8,139	$6,500
FICA	7.65%	7.65%	$4,590	$4,590
State	5.50%	4.74%	$2,846	$2,837
Local	0.00%	0.00%	$0	$0
Total Income Taxes			$15,574	$13,926
Income After Taxes			**$44,426**	**$46,074**

* These will be the taxes owed for the 2018 - 2019 filing season.

Birmingham, AL

1. What is the population?

a. Around 1.3 million people according to Census estimates from 2013.[19] The city of Birmingham does not have very many residents while the surrounding suburbs are rapidly growing. Birmingham is about half the size of Charlotte.

2. Describe the city climate and seasonal fluctuations.

    a. The climate and seasonal fluctuations are very similar to Oxford. The summers are hot and humid, and the winters are mild. An interesting fact is that Birmingham is one of the rainiest cities in the United States, averaging over fifty inches of precipitation each year, compared to the national average of thirty-nine inches.[20]

3. Describe the city's topography, scenery and other geographic or geological features of the area in which the city is located. Include pictures where appropriate.

    a. Birmingham is a surprisingly hilly city. The downtown area is in a valley and there are a lot of surrounding hills and valleys. There are lots of parks and interesting landmarks around the city, including Oak Mountain State Park (the largest state park in Alabama) and Red Mountain Park. There are lots of outdoor activities in and around Birmingham.

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[19] Edgemon, Erin. "Birmingham Sees No Population Growth, Suburban Cities Still Increasing, Census Shows." AL.com. May 25, 2017. Accessed November 05, 2018. https://www.al.com/news/birmingham/index.ssf/2017/05/birmingham_stagnant_chelsea_se.html.

[20] US Department of Commerce, and NOAA. "NWS Alabama Rainfall Plot." National Weather Service. July 29, 2017. Accessed November 05, 2018. https://www.weather.gov/bmx/rainfallplots.

4. What are the individual tax rates in the city? Quantify what this means based on a starting salary of $50,000 per year.
    a. Alabama has a 5 percent individual tax rate and Birmingham has an additional 1 percent tax. My income after taxes at a starting salary of $50,000 would be around $39,168. This would be lower than the amount I would make in North Carolina due to the additional city tax that does not exist in Charlotte.
5. What transportation hubs are in the city?
    a. The Birmingham-Shuttlesworth Airport is located in Birmingham. While it is not the biggest airport it does have flights to major hub airports. Birmingham's public transportation system is called MAX and offers bus services around different parts of the city.
6. What is the city's most prevalent industries?
    a. The medical industry and banking are some of the largest industries in Birmingham. The University of Alabama- Birmingham hospital network employs thousands of people around the city. Regions Bank is headquartered in Birmingham as well as Alabama Power and Vulcan Metals.
7. Describe the quality of the city's healthcare?
    a. Birmingham has very high-quality healthcare due to the large presence of the UAB hospital network as well as St. Vincent's hospital. There are many different options and locations for healthcare facilities around Birmingham

8. What types of crime are common in the city and where are locations in the city to avoid?
    a. The actual city of Birmingham is a dangerous place. It ranked fifth in the US for violent crimes and property crimes for major cities.[21] The downtown area is not very safe, and I probably would not want to live in that area due to the crime and lack of other young people in the area. I would try to not spend a lot of time in the areas with high levels of crime.
9. Based on where you see yourself living for the first three years, how much rent do you expect to pay?
    a. I would like to live in the Homewood area. There are lots of young people that live in the area and my commute to work would be short. I would expect to pay between $1,000 and $1,200 per month. These apartments include a parking space for my car. I would be able to live by myself which would be nice. One of the things I do not like much about Birmingham is how many young people do not live in the downtown area opposed to a city like Charlotte.

[21] "Crime in the U.S. 2014." FBI. May 19, 2015. Accessed November 05, 2018. https://ucr.fbi.gov/crime-in-the-u.s/2014/crime-in-the-u.s.-2014.

1 Bedroom, 1 Bathroom - The Retreat Classic

$1,075 | 895 Sq Ft

1 Bedroom, 1 Bathroom - 1 Bedroom

$1,257 - 1,544 | 953 Sq Ft

10. What is the typical mode of commuting? Based on your answers identified in the prior question, what are the commute times?
    a. If I lived in Birmingham, I would most likely drive myself to work. The traffic is not as bad as it would be in a larger city. I could look into taking the bus, but I probably would not use it very often. Different firms have their offices in different parts of town so that would also have an influence on how I would get there. It would be hard to estimate my commute time because different firms are located in different parts of the city. I would not think it would take more than thirty minutes in each direction.

11. Where will you do grocery shopping?
    a. I would most likely shop at Whole Foods and Publix. There are multiple locations of each around the city, so it would not be hard to find either one. I would be able to drive there and bring my groceries home that way.

This would not be as convenient as walking but definitely not inconvenient.

12. How will you do your laundry?
    a. All the apartments I looked at had a washer and dryer in the unit, so I would do my laundry in my apartment.
13. Name at least three civic, religious or charitable activities you would like to be active in?
    a. I would like to be involved in a church somewhere close to where I live. There are plenty around the city, so I do not think I would struggle to find a home. Some popular churches in Birmingham are Church of the Highlands and Briarwood so I would check those out. I would also like to look into an organization called Birmingham Urban Mountain Pedalers which is a mountain biking club. I would also search for a charitable organization to get involved in, most likely one through my church. If I could not easily find one that way I would like to volunteer with Habitat for Humanity.
14. What are the sports, entertainment or recreational activities that you would like to engage in within the city?
    a. I would primarily like to ride my mountain bike on all the trails around the city and in the towns nearby. Birmingham has a minor league baseball team, so I would probably check out a few of their games. A lot of bands that I like play in Birmingham, so I would also attend lots of concerts. Some accounting firms have sports team and I would like to participate in

a couple if I could. Additionally I would like to go see plays in Mountain Brook during the summer at the amphitheater.

15. What are your modes of traveling back to your hometown from this city? What is the average cost you would incur for each trip back home?
    a. If I lived in Birmingham I would most likely drive home. I could fly, but the amount of time it would take to get through the airport and security it probably would not be much faster than the six-hour drive. It normally takes about a full tank of gas to get from Birmingham to Charlotte, so my cost would be around forty dollars.
16. Based on your findings, develop a model monthly operating budget for each city for Year 2, assuming annual salary is $60,000.

Rent	$1,100
Tithe	$380
Saving	$1134
Food	$500
Fun	$500
Misc	$200
Total	**$3,814**

Your Income Taxes Breakdown

Tax Type	Marginal Tax Rate	Effective Tax Rate	2017 Taxes	2018 Trump Taxes*
Federal	25.00%	13.56%	$8,139	$6,500
FICA	7.65%	7.65%	$4,590	$4,590
State	5.00%	4.09%	$2,452	$2,531
Local	1.00%	1.00%	$600	$600
Total Income Taxes			$15,781	$14,221
Income After Taxes			**$44,219**	**$45,779**

* These will be the taxes owed for the 2018 - 2019 filing season.

17. Based on your full analysis, determine whether you still want to live in both cities, and if so, which one is your preferred city and why?
    a. I would still like to live in both cities after learning more about them. I lean more towards Charlotte for a few reasons. The most important reason is that Charlotte is where almost all my family is. I really enjoyed being able to see my grandparents frequently growing up, and I would like for my kids to have the same experience. Additionally, Charlotte is a much bigger city and has more opportunities for jobs in accounting. This would be better for my career and allow me to remain in the same location for longer. I also love how close Charlotte is to the mountains and enjoy spending my weekends up there. Overall, I think that Charlotte is the best decision for me personally, as well as for my career.

WorldCom Case

Josh Cathey

Accy 420

Dr. Dickinson

November 16, 2018

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

This case prompted us to examine WorldCom and its financial statements. WorldCom has become one of the most well-known accounting scandals in recent memory as the misstatement of their financial records resulted in millions of dollars of value lost and thousands of people losing their jobs. Interesting, some of the chief architects of this deception are graduates of the Patterson School. It is important to examine how and why this happened in order to educate the next generation of accountants to ensure that something such as this does not happen again.

The first part of the case encourages the examination of FASB concepts related to the definition of basic accounting terms. After this, questions are asked regarding how certain events related to the previous definitions should be handled in financial reporting. The accounting process of capitalization of expenses is discussed and explained. The next part of the assignment explores lines costs, which were falsely reported by WorldCom and resulted in the ensuing scandal. These costs should have been expensed but were instead capitalized. The latter part of the case prompts the search for the incorrectly reported items. Amounts are recalculated to reflect the proper amounts in each account if the reporting had been done correctly.

This case provides valuable lessons about how integral trust is to the accounting process. As a profession, we are selling trust. If people do not trust us, our business will not have a future. It is in the best interest of everyone in the profession to conduct business in an honest manner in order to protect their own career, but also the careers of people that depend on work of accountants. Vigilance and oversight from governing bodies also aids in the supervision of all people working in our profession.

1. FASB Statements of Concepts #6
    a. Explain in your own words, how SCON defines “asset” and “expense”

i. An asset is something of value that a company controls that will provide a benefit in periods to come. An expense is a requirement of the company to provide something to another company through the use of its capabilities or possessions. Both of these definitions are integral to the operations of a business and the correct reporting of each one has material impacts on the financial statements.

b. When should costs be expensed and when should they be capitalized as assets?

i. Costs should be capitalized as assets when they add or create new value as a new asset or to preexisting assets. Costs should be expensed when they are not creating new value or maintaining current assets. Both of these circumstances need to be carefully examined by each company to ensure that their reporting is accurate.

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

a. After costs are capitalized, they are depreciated over time. If a cost is capitalized instead of expensed, the amount will slowly hit the income statement through depreciation expense instead of a lump amount at the beginning. The balance sheet will initially be increased by the value added to the asset and will be decreased over time as the depreciation accumulates on the asset.[22]

3. Refer to WorldCom's statement of operations. What did the company report as line costs for the year ended December 31, 2001? Prepare the journal entry to record these transactions for the year. Explain in your own words what these "line costs" are.
    a. WorldCom capitalized these line costs when they should have been expensed. Line costs are an operating expense for the company to use the telecommunications lines around the country that the company does not own.[23] The company reported $14.739 billion as line costs in 2001. The journal entry that should have been used to report these costs would have been:

Operating Expense (Line Cost)	14.739 billion	
Cash/AP		14.739 billion

4. Refer to the WSJ article. Describe the type of costs that were improperly capitalized at WorldCom. Explain, in your own words, what transactions gave rise to these costs. Do these costs meet your definition of an asset in part A?

[22] FASB CON 6, Sec. 104
[23] SEC Complaint: SEC v. Worldcom Sec. 5

a. The costs that were capitalized should have been classified as expenses. The transactions that took place were WorldCom needed to use infrastructure of other companies and they were charged a fee for doing so. This is not what an asset is. What took place is basically the definition of an expense.

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

    a. These costs appeared under "various capital accounts" on the balance sheet.[24] These expenses were assigned to assets instead of being expensed. Under the statement of cash flows this would have incorrectly appeared under the investing category. This misstatement was a material mistake that had significant repercussions afterwards. It should have been under the operating section.

PP&E	3,055,000,000	
Cash/AP		3,055,000,000

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

[24] SEC Complaint: SEC v. Worldcom Sec. 2

a. This assumption would have given the capitalized costs a twenty-year life. The depreciation expense for 2001 would have been calculated at:

$\frac{771{,}000{,}000}{22} \times (12/12) = 35{,}045{,}455$

$\frac{610{,}000{,}000}{22} \times (9/12) = 20{,}795{,}455$

$\frac{743{,}000{,}000}{22} \times (6/12) = 16{,}886{,}364$

$\frac{931{,}000{,}000}{22} \times (3/12) = 10{,}579{,}546$

Depreciation Expense	83,286,820	
Accumulated Depreciation		83,286,820

7. Use your answers from e and f above to determine what WorldCom's net income would have been in 2001had line costs been improperly capitalized. Use 35% as an approximation of WorldCom's 2001marginal income tax rate, in your calculations. State any other assumptions you make. Is the difference in net income material?

    a. WorldCom's net income would have been decreased by the difference between the amount that was incorrectly charged to PP&E and the amount of depreciation expense that was recognized, net of tax. The calculations for this are as follows:

3,055,000,000- 83,286,820= 2,971,713,180 x (1-.35)= 1,931,613,567

The difference in net income would be material because the company is now suffering a loss for the period. Net income (loss) would now be calculated as:

1,501,000,000- 1,931,613,567 = (430,613,567)

Starbucks Case 7

Josh Cathey

Accy 420

Dr. Dickinson

March 6, 2019

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

This case analyzes the financial statements of Starbucks in 2013. The SEC filings were examined in combination with provided information. It was interesting to search through the SEC website to see what information was available about public companies. I was surprised by the sheer amount of information that each company is required to file each year. After the information was pulled, some overarching questions had to be answered about the company. First, the nature of Starbucks and their business operations was discussed. To understand a business, it is important to know about how it functions. Starbucks is an intricate business with multiple sources of income. Next, the specific financial statements that Starbucks creates were discussed. Starbucks uses a specific nomenclature for these documents and the reason behind this was discussed. Federal regulations about reporting were mentioned as well as optional elections by companies beyond those requirements related to the frequency of financial reporting. The internal process of creating financial statements and ensuring their accuracy was deliberated. In addition, external auditors and their role in the preparation of financial statements was discussed as well as what impact their opinions have. The consolidated income statement and balance sheet of the company were updated to include common information. The financial statements of the company were analyzed to identify trends and anomalies in the given years. Certain parts of their financial information were elaborated on to create an understanding of some of the subjective parts of financial reporting.

This case prompted research in order to provide a deeper understanding of financial reporting and the ambiguities related to that. The process of preparing these statements is far from perfect and judgement is used in many steps along the way. Learning to understand how to decipher some of the information allows for a better understanding of how business functions.

Questions

a) What is the nature of Starbucks' business? That is, based on what you know about the company and on the accompanying financial statements, how does Starbucks make money?

   i) Starbucks makes money by selling products to consumers. Their sales are comprised of a mix of sales from their brick and mortar stores as well as sales of their products through other venues such as supermarkets and convenience stores. These sales of physical items are the primary drivers of the business.

b) What financial statements are commonly prepared for external auditing purposes? What titles does Starbucks give these statements? What does "consolidated" mean?

   i) An income statement, balance sheet, statement of comprehensive income, statement of cash flow and statement of equity are commonly prepared for external auditing purposes. Starbucks calls these items, "Consolidated Statement of Earnings, Consolidated Balance Sheets, Consolidated Statement of Comprehensive Income, Consolidated Statement of Cash Flows, Consolidated Statement of Equity". Consolidated means that some of the details of the statements have been collapsed or summarized in order to present a simpler document that is easy to read and understand.

c) How often do publicly traded corporations typically prepare financial statements for external reporting purposes?

i) Financial statements are usually prepared at the end of the fiscal year of the company. Some companies elect to prepare these statements multiple times a year, often in a condensed form. This is meant to provide time-sensitive information to investors and keep all of the stakeholders of the company up to date on the operations of the company. Much of this is left to the discretion of the companies.

d) Who is responsible for the financial statements? Discuss the potential users of Starbucks financial statements and the type of information they are likely interested in.

i) Corporations typically have dedicated employees that assist in the cyclical preparation of financial statements. Information is pulled from the operations of the business and synthesized into the statements. Many companies have procedures to ensure the accuracy of reported information and an established process to prepare the statements. The typical users of their financial statements would be stakeholders of the business. This would be comprised of bondholders, stockholders, employees, as well as other investors and people who are interested in the business. People who have a vested interest in the company performing well would care about the information presented in the statements. These people would be interested in performance ratios such as Times Interest Earned, liquidity ratios, as well as disclosed information about potential liabilities and other business information.

e) Who are Starbucks' external auditors? Describe the two "opinion" letters that Starbucks received in 2013. What do these opinions mean? Why are both opinions dated several months after Starbucks' year-end?

   i) Their external auditor is Deloitte Seattle. In 2013, two opinion letters were received from Deloitte. The first one asserts that while the documents are the responsibility of the company, Deloitte affirms the assertions made by the company. Deloitte claims that as far as they are aware, the information reported is accurate and truthful. This means that investors should be able to use this presented information to aid in their decision making backed up by the assurance of the firm. The second letter says that in Deloitte's opinion, the internal controls of Starbucks are effective and functioning properly. Deloitte tested these controls based on the Internal Control Integrated Framework and stands by their claims of proper function. These opinions are dated after the year-end because it takes time for the firm that does the audit to test the company's assertions and verify the information presented.

f) Construct a common-size income statement and balance sheet

Common Statements Of Earnings (USD $) In Millions, except Per Share data, unless otherwise specified	12 Months Ended			COMMON	
	Sep. 29, 2013	Sep. 30, 2012	Oct. 02, 2011	2013	2012
Net revenues:					
Company-operated stores	$11,793.20	$10,534.50	$9,632.40	79%	79%
Licensed stores	1,360.50	1,210.30	1,007.50	9%	9%
CPG, foodservice and other	1,738.50	1,554.70	1,060.50	12%	12%
Total net revenues	14,892.20	13,299.50	11,700.40	100%	100%
Cost of sales including occupancy costs	6,382.30	5,813.30	4,915.50	43%	44%
Store operating expenses	4,286.10	3,918.10	3,594.90	29%	29%
Other operating expenses	457.2	429.9	392.8	3%	3%
Depreciation and amortization expenses	621.4	550.3	523.3	4%	4%
General and administrative expenses	937.9	801.2	749.3	6%	6%
Litigation charge	2,784.10	0	0	19%	0%
Total operating expenses	15,469	11,512.80	10,175.80	104%	87%
Gain on sale of properties	0	0	30.2	0%	0%
Income from equity investees	251.4	210.7	173.7	2%	2%
Operating income	-325.4	1,997.40	1,728.50	-2%	15%
Interest income and other, net	123.6	94.4	115.9	1%	1%
Interest expense	-28.1	-32.7	-33.3	0%	0%
Earnings before income taxes	-229.9	2,059.10	1,811.10	-2%	15%
Income taxes	-238.7	674.4	563.1	-2%	5%
Net earnings including noncontrolling interests	8.8	1,384.70	1,248	0%	10%
Net earnings attributable to noncontrolling interest	0.5	0.9	2.3	0%	0%
Net earnings attributable to Starbucks	$8.30	$1,383.80	$1,245.70	0%	10%
Earnings per share - basic	$0.01	$1.83	$1.66	0%	0%
Earnings per share - diluted	$0.01	$1.79	$1.62	0%	0%
Weighted average shares outstanding:				#VALUE!	#VALUE!
Basic	749.3	754.4	748.3	5%	6%
Diluted	762.3	773	769.7	5%	6%
Cash dividends declared per share	$0.89	$0.72	$0.56	0%	0%

Common Balance Sheets (USD $) In Millions, unless otherwise specified	Sep. 29, 2013	Sep. 30, 2012	COMMON 13	12
Current assets:				
Cash and cash equivalents	$2,575.70	$1,188.60	22%	14%
Short-term investments	658.1	848.4	6%	10%
Accounts receivable, net	561.4	485.9	5%	6%
Inventories	1,111.20	1,241.50	10%	15%
Prepaid expenses and other current assets	287.7	196.5	2%	2%
Deferred income taxes, net	277.3	238.7	2%	3%
Total current assets	5,471.40	4,199.60	48%	51%
Long-term investments	58.3	116	1%	1%
Equity and cost investments	496.5	459.9	4%	6%
Property, plant and equipment, net	3,200.50	2,658.90	28%	32%
Deferred income taxes, net	967	97.3	8%	1%
Other assets	185.3	144.7	2%	2%
Other intangible assets	274.8	143.7	2%	2%
Goodwill	862.9	399.1	7%	5%
TOTAL ASSETS	11,516.70	8,219.20	100%	100%
Current liabilities:				
Accounts payable	491.7	398.1	4%	5%
Accrued litigation charge	2,784.10	0	24%	0%
Accrued liabilities	1,269.30	1,133.80	11%	14%
Insurance reserves	178.5	167.7	2%	2%
Deferred revenue	653.7	510.2	6%	6%
Total current liabilities	5,377.30	2,209.80	47%	27%
Long-term debt	1,299.40	549.6	11%	7%
Other long-term liabilities	357.7	345.3	3%	4%
Total liabilities	7,034.40	3,104.70	61%	38%
Shareholders' equity:				
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units),	0.8	0.7		
Additional paid-in capital	282.1	39.4		
Retained earnings	4,130.30	5,046.20		
Accumulated other comprehensive income	67	22.7		
Total shareholders' equity	4,480.20	5,109		
Noncontrolling interests	2.1	5.5		
Total equity	4,482.30	5,114.50		
TOTAL LIABILITIES AND EQUITY	$11,516.70	$8,219.20		
[1]	In conjunction with the change in reportable operating segments, we			

g) Refer to Starbucks' balance sheet for fiscal 2013

i) Demonstrate that the accounting equation holds for Starbucks

i) Accounting Equation Proof: 11,516.70- 7,034.40 = 4,482.30 (A-L=E)

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

    i) Major assets consist of Cash and Cash Equivalents, and PPE. Short term assets make up 48 percent of assets and long-term assets make up 52 percent. (5,471.4/11,516.7=.48), (6,045.3/11,516.7=.52). This seems appropriate for a company that balances creating and serving a perishable product with investing in long term assets such as stores and product lines.

iii) In general, what are intangible assets? What is goodwill? What specific intangible assets might Starbucks have?

    i) Intangible assets are resources that the company has an ownership interest in that can provide a possible future benefit to the company but are not physical objects. Goodwill is recorded when the purchase price of a subsidiary exceeds the fair market value of that company. This is an amount that should not be amortized or otherwise altered during the normal operations of the business. Starbucks probably has intangible assets related to their brand reputation and recognition as well as acquisitions of other companies. The Starbucks brand is known worldwide and has a strong value.

iv) How is Starbucks financed? What proportion of total financing comes from non-owners?

    i) Starbucks is financed primarily from long term debt with some funding coming from equity. The vast majority of funding is from debt. 82 percent of funding comes from non-owners (1,299.4/(1,299.4+282.9). Many companies and investors prefer to see companies primarily financed by debt.

h) Refer to Starbucks' statement of earnings for fiscal 2013 and the common IS developed

   i) Review the revenue recognition policies of Starbucks discussed in Note 1 (Summary of Significant Accounting Policies). Does Starbucks record revenue when they receive cash from their customers (cash-basis accounting) or do they follow a different rubric (for example, accrual accounting)? How does Starbucks record revenue on stored value cards (i.e., gift cards)? What challenges in measuring revenue do you observe? That is, are there any significant judgments management needs to make in recording sales revenues at Starbucks?

      (1) Company owned stores recognize revenue when payment is received at the counter. For licensed stores, revenue is recognized when goods are shipped to the stores. Wholesale sales are recorded under the accrual method. Revenue from stored value cards is recognized when redeemed or during the period of likely redemption. A challenge Starbucks would face is that they are utilizing multiple methods to record revenues which could get confused over time. Some departments may mistakenly record revenue under a method that is meant for another. One judgement that management would need to make is when revenues from stored value cards are

expected to be recognized. These cards can be seen to fall into multiple categories, so some discretion is necessary.

ii) What are Starbucks' major expenses?

(1) Starbucks major expenses consist primarily of costs to operate their stores, and the cost of sales meaning the ingredients for their drinks and other food. Labor costs are also a significant portion of their expenses. This makes sense due to the nature of their business. The high costs indicate the quality of their ingredients and stores.

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

(1) There were not any significant changes in the cost structure, besides the presence of a large litigation charge that took up 19 percent of net revenues. Most of the other ratios shown in the common income statement are roughly the same as the previous year.

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

(1) Starbucks claimed that they booked the expense to operating because they had enough cash on hand and borrowing capacity to pay off the litigation. In addition, this could help reduce confusion of investors seeing an unusually high amount in General and Administrative Expenses. Another

reason that Starbucks considered this an operating expense is because they believed the loss contingency could not be predicted beforehand.

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

(1) The normal operations of the company were profitable in both years. I would define "profitable" as the operating revenue exceeding the operating expenses. In 2013 the legal expense was included in operating income, resulting in a loss. This net loss was an anomaly and should not be used as the only way to determine profitability. The normal business operations produced a profit, except for the unusually high legal expense.

i) Refer to Starbucks' fiscal 2013 statement of cash flows.

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

(1) Net earnings were very low compared to cash provided by operating activities due to the large legal expense that was included in the year. Other years that are shown report higher values for net earnings. Most of the cash that was earned was used to help pay off the litigation charge. In normal years, depreciation and amortization take out a large amount of the cash provided by operations. This is caused by the large physical presence of the company.

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

(1) In 2013 Starbucks used 1,411.20 million for expenditures in PPE. This information is available in the Statement of Cash Flows.

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

(1) In 2013 Starbucks paid $628.9 million in dividends. During the year, $668.6 million in dividends were declared. Some dividends are currently outstanding and have not been paid. This information is available in the presented financial statements.

j) Several notes to the financial statements refer to the use of "estimates." Which accounts on Starbucks' balance sheet require estimates? List as many accounts as you can. Are any accounts estimate-free?

i) Estimates are used for inventory due to shrinkage and slow-moving inventory. Estimates are also used for PPE for depreciation as well as useful life. Goodwill is estimated as well as other intangible assets. Under some circumstances, it is not possible to directly track each transaction that involves each account. Allowance for Doubtful Accounts is estimated as well to account for customers that will not pay the balance on their account based on estimates from previous periods. Estimates are used to provide a good idea of the balance of the account because finding the exact amount would be cost-prohibitive. One could argue that no account is truly estimate-free due to the inherit uncertainty of the real world.

BP Case

Josh Cathey

Accy 420

Dr. Dickinson

April 3, 2019

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

This case prompted the analysis of situations regarding contingent liabilities, mainly focusing on the Deepwater Horizon oil spill and how BP dealt with reporting the aftermath. Initially, the nature of contingent liabilities and the specifics of their reporting were discussed. Common types of contingent liabilities and their counterpart, contingent gains were discussed. The definitions of these terms help guide how they should be reported. Next, a contingent liability for the manufacturer is looked at from the side of the customer and how it should be reported. Knowledge of the intricacies of assurance and service-type warranties are necessary to understand how these items should be reported accurately.

Subsequently, the judgements relevant to reporting contingent liabilities are discussed. The amount, timing and uncertainty of these liabilities is crucial to accurate reporting. Additionally, the different kinds of contingent liabilities that may arise are analyzed. Some of these liabilities can be reasonably predicted and others are relatively unknown until they arise. Contingent liabilities that meet the criteria of being likely to happen and of a predictable amount are reported in the financial statements. In a normal course of business, it will never be possible to predict all these events beforehand, so it is important to know how to handle uncertainty within the process. This disaster resulted in numerous deaths and billions of dollars of damages to the surrounding ecosystem and economy. Dealing with situations such as this requires advanced technical knowledge of the proper methods and guidelines related to contingent liabilities.

Questions

a) What is a contingent liability? Explain when a company would record a contingent liability on its books. List some types of contingent liabilities. Do companies ever record contingent assets (gains)?

i) A contingent liability is a possible liability that exists in the future. This potential liability is dependent on future events to determine the nature, amount and parties involved related to the liability. A company should record a contingent liability if it has been determined the future events that would create the liability are probable going to occur and the amount of the liability can be realistically estimated. Some types of contingent liabilities are warranties, litigation and environmental liabilities. Companies never report contingent assets or gains, they would only report it in the notes of the financial statements if it is very likely that the gain will occur. Often, there will be no information about gain contingencies in the financial statements.

b) Product warranties are a common contingent liability. Consider a piece of equipment such as a telescopic joint, which BP purchases from GE Oil and Gas. From BP's perspective as the purchaser of the telescopic joint, what is a product warranty? From the perspective of GE Oil and Gas, the manufacturer, what is a warranty?

i) From BP's perspective, the product warranty on the telescopic joint is part of the telescopic joint asset. The assumption of proper functionality is built into the asset and would not require any additional items on the balance sheet. From the perspective of GE Oil and Gas, the liability is most likely reported as a contingent liability. Some of the details about how it should be reported would depend on whether this is an assurance or service-type warranty. This is a contingent liability because it might create a performance obligation in the future that would cost GE to service or repair.

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

   i) Management would need to make judgements about the expected amounts of the warranty costs and the timeline within which they will be incurred. The amount of warranty cost can be based on historical evidence or estimates from the firm. The timeline can be based on the expected lifetime of the item sold and past evidence of when warranty costs are incurred. The timing and amount of contingent liabilities are necessary to make a reliable estimate of the cost to be recorded. A claim for damages resulting from the oil spill were unexpected and not predicted beforehand. Each legal claim from the oil spill would result in varying amounts of payments that BP must make and would not be a known amount until the litigation is settled. A warranty claim is something that has been predicted beforehand and recorded in a way that there are not unexpected or other adverse impacts on the financial statements. The oil spill was an unexpected event that resulted in massive legal litigation fees.

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

i) BP must estimate amounts related to the cleanup of the spill as well as other amounts such as litigation fees, economics loss claims, securities settlements, and government fines. These amounts all vary and would not be reasonably estimable beforehand. BP has had to repeatedly update their estimates of the total costs that would be incurred. As an auditor working with the firm, it would be vital to determine which costs are reasonably estimable and to determine ways to estimate these costs. The guidelines for reporting contingent liabilities is dependent on the amount and probability being reasonably estimable and this information would be very important to BP. Analysis of what remains of the clean up efforts, possible future litigation and fees from government associations would be a good place to start for an audit team. These amounts must be frequently evaluated to determine what is remaining and if past estimates remain accurate for the current situation of the firm.

Wendy's Case

Josh Cathey

Accy 420

Dr. Dickinson

April 10, 2019

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

Questions

a) In general, why do companies enter into joint-venture agreements?

   i) Joint-venture agreements allow companies to team together with another company to reduce the risk of a new investment. Joint-venture agreements allow firms to share profit and loss in their new operation together.

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

   i) The equity method accounts for an investment at the cost of acquisition at time of purchase. Under this the method the investor treats the investment as an account that is linked to the Retained Earnings account of the investee. The circumstances that call for the use of this method involve the investor owning 20-50% of the investee and having the ability to exert significant influence within the company. The balance in this investment account fluctuates based on the reported value of the Retained Earnings account, prorated to the percentage that is owned by the investor. When the investee earns income, the investor increases the investment account balance by the incremental percentage that is owned. When the investee pays dividends, the investor reduces the investment account balance in the same way. This adjustment is typically made upon the release of financial statements of the investee.

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

   i) Under these circumstances, the investor will have to split the excess funds between different accounts. Some of the funds will be used to write up the identifiable net assets to their fair value. This allocation will go into an account called Acquisition Accounting Premium. The investor does this because many companies report assets at their depreciated cost on their books instead of fair value. If there is remaining money in excess, the firm will put that towards Goodwill. In the United States there is no impairment of Goodwill, but the firm will periodically test the amount for impairment. The investor will now need to make periodic entries to record amortization and depreciation on the written-up value. The investee will not need to make these entries.

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

   i) In 2011 the amount for the equity investments was $91,742 million for the Joint venture with Tim Hortons and $77 million for the Joint venture in

Japan. In 2012 the company reported $89,370 for the Joint venture with Tim Hortons and a $1,750 credit for the Joint venture in Japan. On the consolidated balance sheet, this appears under the Investments section in the Equity investments subsection. The amounts vary between the year due to amortization and depreciation of the written-up cost at acquisition. Additionally, the Japanese joint venture has a credit due to an agreement to finance anticipated future cash requirements.

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

   i) The difference in these two accounts is due to Acquisition Accounting Premium which is the amount that Wendy's wrote up the identifiable net assets of Tim Hortons. This amount in Acquisition Accounting Premium is now being depreciated and amortized. 50% of Tim Horton's net assets belong to Wendy's due to their investment. According to Tim Horton's 2012 balance sheet, 50% of their net assets is worth $35,283 million. Wendy's has the investment at a value of $89,370. This difference equates to $54,087 million and is the amount in that is dispersed between Acquisition Accounting Premium and Goodwill. Wendy's paid more than the amount that Tim Horton's had their net assets on the books which creates the differences in amounts.

f) Consider the information disclosed in Note 8 regarding Wendy's investment in the TimWen Joint Venture.

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

      1) This amount appears in Other Operating Expenses in both fdsafyears. In 2012, Wendy's share of Tim Horton's net earnings is $13,680 million which appears in Equity in earnings for the period. This amount was reduced by Amortization of purchase price adjustments in the amount of $3,129 million as well as a reduction of $15,274 million due to dividends received. A foreign currency translation adjustment caused an increase of $2,351 million.

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

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

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

g) Consider the information in the statement of cash flows.

   i) The operating activities section of the statement of cash flows reports a negative adjustment for "Equity in earnings in joint ventures, net" of

$8,724 in 2012. Reconcile this amount to the information disclosed in Note 8. Explain why a negative adjustment is made to arrive at net cash from operating activities.

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

Johnson & Johnson Case

Josh Cathey

Accy 420

Dr. Dickinson

April 19, 2019

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

This case prompted the examination of the pension plans of Johnson & Johnson. Pension plans are often very large obligations for companies and the proper reporting and documentation for them is vital to accuracy and faithful representation. The conceptual part of the case began by identifying the differences between defined benefit and defined contribution plans. In recent years, defined benefit plans have decreased in popularity and defined contribution plans are becoming more prevalent. The differences between the two plans were discussed as well as why the retirement plan obligations are viewed as liabilities. The calculation of pension obligations are based on complicated formulas and some of the factors that go into the calculation were discussed. The components of pension expense were discussed by examining the nature of each part and what effect it has on the related accounts. The differences between actual and expected returns on plan assets were discussed to show the discrepancies in how the expense is reported.

The procedural part of the case prompted analysis of the presented financial statements and related notes. The pension expense and related components were identified, and their amounts discussed. The valuation of the different investment accounts was discussed to understand what gives rise to the differences between the pension benefit obligation and the plan assets. The transactions that impact the PBO as well as plan assets were identified to show how these balances fluctuate. The underfunded status of the plan was discussed as well as what impact this has on the financial statements of the company. As the population of America continues to age and many public institutions have severely underfunded pension plans, this topic will increase in significance for the accounting profession as well as the general public.

Questions

a) There are two general types of retirement plans- defined benefit plans and defined contribution plans

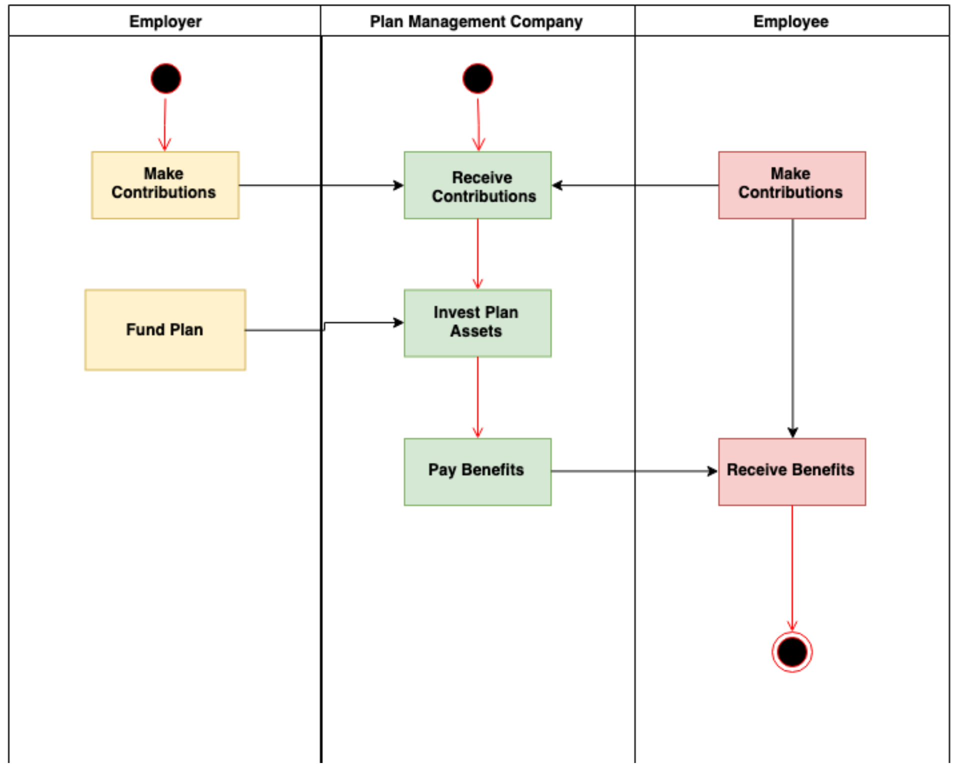
   i) How do these two types of plans differ? Which type does Johnson & Johnson have?

      1) Defined benefit plans mean that employees receive a defined benefit upon their retirement. This benefit is normally based on the salary they earned during their career as well as the number of years that the employee worked. A defined contribution plan is a plan where the employee and company make a contribution each period based on a defined formula. Johnson & Johnson has a defined contribution plan due to the fact that the company makes contributions to the plan each year based on employee contributions.

   ii) Explain why retirement plan obligations are liabilities

      1) Retirement plan obligations are liabilities because they are a future obligation that the company will have to settle using assets. The company must fund the plan each period to ensure that the benefits can be paid to the recipients. The below class diagram shows the

relationship between the different parties involved.



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

1) Some of the assumptions that are necessary to account for retirement plan obligations are the future salaries of employees, the number of employees, and the number of years the employees will live after retirement. Other assumptions such as improvements in medicine, national health trends and other relevant factors should be monitored in order to have an accurate estimate.

b) In general, companies' pension obligations are influenced by four types of activities. Explain each of the four activities in your own words.

i) Service cost is the benefit cost that is incurred due to the work that employees perform in the current year. This amount is determined by the formulas that have been calculated. Service cost increases pension expense and the PBO. Interest cost is based on the settlement rate determined by the company and the beginning balance of the PBO. This amount reflects the time value of money related to the PBO. Interest cost increases pension expense and the PBO. Actuarial gains and losses are based on the plan assets. These assets are invested by the firm that the company uses to manage their retirement plans. Pension expense is based on the estimated return on these assets, but sometimes the actual return is different from the expected one. This results in a gain or loss that either increases or decreases pension expense if it meets certain criteria. Benefits paid to retirees represents a decrease of the PBO and the plan assets. These benefits are based on previously defined plans that are now being exercised by the employees.

c) In general, companies' pension assets are influenced each year by three main types of activities. Explain each of the three items in your own words.

    i) Actual returns on pension investments are the returns that are generated by the plan assets that are invested. The firm that has control of the plan chooses investments that it believes will provide a stable return for the company. These returns increase the plan assets and decrease pension expense. Company contributions to the plan increase plan assets and decrease cash. This contribution is normally based on a formula determined by the company that manages the plan and ensures that the firm will have adequate funds to pay the benefits to retirees in coming years. Benefits paid to retirees decreases plan assets and the PBO. These payments can either be for a defined benefit or defined contribution plan and go directly to the employee to which they are due.

d) In general, companies' pension expense and pension plan assets both have a "return on plan assets" component. How do the two returns differ? Explain the rationale for this difference.

    i) The pension expense is based on expected returns and the pension plan assets are based on actual returns. These returns differ based on if the firm actually earned the expected amount on their investments. Pension expense is based on the estimated amount of returns because of a compromise made by the FASB. This was due to conflicting interests of parties involved in the creation of the standard. If there is a difference between the expected and actual return it will be recorded as an asset gain or loss for the period.

e) Not Included

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

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

        1) In 2007, Johnson & Johnson reported $646 million in pension expense. This amount is reported as the Net Periodic Benefit Cost.

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

   1) Dr. Pension Expense 1,253,000,000

      Cr. PBO 1,253,000,000

g) Consider Johnson & Johnson's retirement plan obligation, that is, the pension liability, as detailed on page 62.

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

      1) At December 31, 2007, the value of the retirement plan obligation is \$12.2 billion. This value represents the current cost of the benefits the firm will have to pay out to retirees in coming years. This number is as reliable as the company believes the underlying formulas used to calculate it are. It is likely to change due to fluctuations in currency value, life expectancy and other factors that are out of control of the company.

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

      1) The pension-related interest cost for the year is \$656 million. The average interest rate used would be 5.62%. This amount can be calculated by dividing the amount reported for interest cost (\$565 million) by the initial balance of the PBO (\$11,660 million). This rate

seems reasonable based on the overall market conditions and return that could be expected on other investments in the market.

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

1) In 2007, $481 million in benefits were paid from the plan, as disclosed in the financial statements. Johnson & Johnson did not pay cash for these benefits, they were paid from the plan assets that are in control of the company that manages their pension. Benefits paid reduce the PBO as well as the plan assets.

h) Consider Johnson & Johnson's retirement plan assets, that is, the pension plan asset, as detailed on page 62 of the company's annual report.

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

1) At December 31, 2007, the balance of the retirement plan assets is $10,469 million as disclosed in the financial statements. This value is the amount of the plan that has been funded by Johnson & Johnson and is being held by the company that manages the pension. The plan is currently underfunded because the balance in the PBO exceeds the balance of the plan assets.

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

1) In 2006, the actual return on plan assets was $966 million while the expected return was $701 million. In 2007, the actual return on plan assets was $743 million while the expected return was $809 million. These differences are significant and must be amortized if in excess of the corridor that is determined by the beginning balances of AOCI and the greater of the beginning balances of the PBO and the plan assets. The actual return better reflects the economics of the pension expense, but because companies influenced the setting of the standard, they are allowed to use the expected return. However due to the corridor method, the company must eventually reflect what the actual returns are.

iii) How much did Johnson and Johnson and their employees contribute to the retirement plan during 2007? How does that compare to contributions in 2006?

1) In 2007, Johnson & Johnson contributed $317 million and employees contributed $62 million. In 2007, Johnson & Johnson contributed $259 million and employees contributed $47 million. Contributions increased for both the company and employees in 2007. This could have been caused by an increase in employees or a new incentive

introduced that encourages employees to contribute to their retirement plans.

iv) What types of investments are in Johnson and Johnson's retirement plan assets?

1) The retirement plan assets are invested in a mixture of equity and debt securities. In 2007, 79% of the plan assets were invested in equity securities while 21% was invested in debt securities.

i) Is the company's retirement plan under funded or over funded at December 31, 2007? At December 31, 2006? Where does this funded status appear on the company's balance sheet?

i) The plan is underfunded at both dates. In 2006, the plan is underfunded by $5,584 million and in 2007 the plan is underfunded by $5,402 million. The overfunded or underfunded status of the plan is determined by finding the difference between the PBO and the plan assets. If the PBO is greater than the plan assets, the plan is underfunded. This appears on the balance sheet under the category of liabilities.

ACCOUNTING MODELS AND BASES FOR FINANCIAL REPORTING

Josh Cathey

Accy 420

Dr. Dickinson

April 26, 2019

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

1. Summarize the article.

This paper discusses the balance sheet method of accounting and argues that it is “flawed”. The authors present four flaws that are the framework of the argument. The first being that the balance sheet method does not match the revenue and expense process that many companies use to create value. The second point is that income is a more useful metric than assets. The third point is that financial reporting should be optimized to more accurately reflect earnings. The final point being that the current approach encourages the use of estimates and valuation accounts which is not reflective of reality. The introduction of the paper explains that the FASB was at the time rethinking the conceptual framework that US standards operated on but were not rethinking the balance sheet approach. The authors hoped that their paper could encourage them to do so.

The next part of the article provides historical information about how the current standard came to be. Balance sheet approach ideals were rooted in the idea that the correct valuation of assets and liabilities was the primary goal of financial reporting. This is contrasted by the income statement approach that determines revenues, expenses and earnings as the key information provided by financial reporting. The income statement approach has support from many in the accounting community as well as those in investing. Historically, the income statement approach was commonly used and was the normal practice of the industry until the 1970s. This change was associated with the rise of the FASB which replaced the less powerful APB. The FASB had more power than the outgoing APB and used this clout to influence accounting standards. Operating with their new authority, the FASB set its mind to set either the balance sheet or income statement approach as the primary reporting method for companies in the United States. The balance sheet approach was chosen for its purported "conceptual superiority". This superiority was determined by clear definitions of assets and liabilities opposed to the nebulous meaning of "value". The power and success of the FASB has been influenced standard setting around the world. Organizations such as the IASC have modeled their standards on those published by the FASB. In recent years, the FASB has cooperated with international organizations in efforts to converge accounting standards around the world. Close to the time this article was written, the FASB published their Preliminary Views which seek feedback on the current framework that is supported by the organization. These Preliminary Views reveal that the FASB does not view earnings as the most important component of financial statements, which the authors disdain.

The next part of the article fleshes out the complaints the authors have with the balance sheet approach. The first grievance is based in the notion that the balance sheet approach is not concordant with how many companies are operated and create value. The authors claim that most companies are more focused on using assets as a way to advance liabilities and obtain future earnings. A comparison of an "asset furnace" is used to demonstrate how assets are merely resources that are used by the company for the means of "advancing expenses to earn revenues". Therefore, the authors argue, assets are not the main concern of the business and therefore should not be the most important information reported in the financial statements. The argument is furthered through claims that the balance sheet approach diverts attention from the ongoing operations of the business which is the key driver of value for a firm. PPE is used as an example to show that a very large category on the balance sheet is not very closely related with the external operations of the firm. PPE levels are often 25 to 100 times the level of sales, making them seem much more important than a more accurate measure of success for the company. The authors provide a counterargument that for some companies, such as one that sells marketable securities, the balance sheet approach is an accurate way to capture the operations of their company.

The second problem the authors have with the balance sheet approach is that the purported conceptual superiority of the balance sheet approach may not be so. The definitions that FASB uses to justify balance sheet accounting is based in the definition of assets. This definition says that assets give rise to “possible future benefits”, which the authors claim is very similar to earnings. Therefore, due to the bad logic of the FASB, the income statement approach would provide a more substantive definition. The authors argue that the definition of income is easier to define, especially over long periods of time. This is due to the convergence of income and net cash flows over a period of years. This standard of “making money” is applicable to many different business practices, as most need to earn income in some way to survive. The third objection is that the balance sheet approach is responsible for an alleged decline in the forward-looking usefulness of earnings. Earnings are an important consideration for investors to determine the value of stock and future outlook for the organization. Research has shown that the balance sheet method has caused increased earnings volatility and reduced earnings persistence, without there being actual changes in the underlying economy. This has led to a breakdown of the relationship between earnings and stock prices over time. The authors claim that over time this will cause a breakdown in the usefulness of the accounting profession and an increased turn to non-GAAP methods to derive the value of a business. The last problems the authors state with the balance sheet approach is that there are many problems with applying the balance sheet method. The authors claim that the extensive use of estimates in financial reporting has led to subjectivity and in some extreme cases, illegal activity such as the Enron scandal. A point is made that the balance sheet approach creates a "feedback loop" that can stimulate market bubbles. The faith in market prices being an unfailing standard can promote instability as market prices are sometimes not linked to real value.

In the last part of the article, the authors provide a framework for what they believe to be a "better conceptual framework" from the perspective of an outside investor. The changes are rooted in a distinction between operating and financing activities. The companies should identify this contrast in order to provide information that is more useful to investors. This would move away from the traditional single bottom line but the authors believe that this would be for the best. The goal of this proposed approach is to "make the accounting reflect and follow the economic logic of the business as much as possible.

2. How did reading the article change your current way of thinking?

I enjoyed reading this article because it prompted me to think about some topics in accounting that I have background knowledge about but have not spend a lot of time examining. Everything the authors say makes sense and would certainly be useful from the perspective of an investor. It made me wonder how difficult it would be for businesses to make these changes to how their financial reporting works. There is always pushback about change but I wonder if some companies would perhaps welcome this new method of financial reporting. A method that makes earnings more useful and reduces volatility seems to be a better solution for all parties involved. It is easy for me to accept what is taught and keep operating under the status quo. The authors of this article have clearly spent a good deal of time pondering the nature of accounting.

This article helped to change my way of thinking in regards to what the purpose of financial reporting should be. If it is truly for the good of the public and investors, it would make most sense to tailor the information that is provided to be most helpful for these parties. The current way of optimizing the information for the company does not seem to make sense. The volatility that is present with the balance sheet approach seems to be detrimental where the income statement approach would provide more useful information. After reading this article, I am encouraged to continue questioning the current accounting standards and practices. It is important for the public to speak up to the organizations that influence and set the rules for our lives and work. This article is a great example of doing so.

At this time in my accounting career, I have not been exposed to what the actual daily routine is like for a public accountant or someone that prepares financial statements for an organization. I have enjoyed learning the concepts behind the actions that these parties perform but without seeing the realities on the ground, it can feel hard to understand some of what the article is saying. I believe that this article promotes a healthy habit of challenging the commonly accepted practices of the industry and is a good reminder to me that once I enter the workplace I should not just blindly accept the methods and practices of my employer. Through constructive feedback and nudges in different directions, all of the parties involved in the accounting process can help each other move in the right direction for the industry as a whole as well as the public.

3. How will you use this information in your future career?

In my future career, I can use this information to try and influence the creation of financial reports by means of lobbying the FASB or working with my employer to create financial statements that provide useful information. I am lucky to have a relative that has worked for the FASB in the past and I know from talking to him that the process of standard setting is collaborative in nature and that the concerns of all parties involved are heard and decisions are not made in a vacuum. If there is enough interest expressed by the business community, it is very likely that the FASB could change the standards related to this topic. I believe it would be a great experience to perhaps work in the FASB one day on a rotation or in some other capacity. I would enjoy the opportunity to be part of the decision making process that has impact on companies in the United States and around the world.

Specifically, I can use this information to guide how I view information that is presented on financial statements under the current approach. The ability to understand the interconnectedness of the statements and filter out what parts of the presented information is not related to the normal operations of the business or help to predict future cash flows would help me make more informed decisions about investments. This article made it clear that the current method of financial reporting does not provide information that is highly reliable and useful for decision making for investors. What sets apart the public from a trained investor is the ability to decipher this information and pick out the relevant information.

One of the things that I enjoy about accounting is that is always seems that there is something new to learn. This article is a great example of that. Due to the multitude of parties that are involved or are interested in the accounting process, there are numerous diverse views on each topic. The publication of literature that challenges the commonly accepted and utilized methods are key to keep the industry in check and further optimize the presentation of information. Our job is important to protect the public from making uninformed decisions. Any kind of reasonable optimization that our industry can make to further ensure the accuracy and usefulness of financial reporting should be undertaken by the governing bodies.

Google Case

Josh Cathey

Accy 420

Dr. Dickinson

May 3, 2019

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case.

Joshua Cathey

Summary

This case prompted the analysis of non-GAAP information related to financial statements. Google was used as an example as their stock price performance was shown throughout a year and in relation to their release of non-GAAP earnings guidance. The first part of the case allowed the examination of methods Google used to reconcile GAAP and non-GAAP net income. The information that was disclosed in this information provided a keen insight into understanding how the investment community valued the company at the time. I learned that although companies must follow GAAP guidelines for their financial statements they are allowed to later disclose information that they feel is relevant to investors and does have an impact on the stock price. A graph showing the stock price of Google was shown in relation to the release of the company's earnings. This graph prompted the analysis of the link between the stock price and the company's earnings reports. Specific changes in the stock price of the company were compared to the market and analysis of marker perception of the company's earnings followed. There seems to be a strong connection between favorable earnings reports and an increase in stock prices.

After reading the WSJ article at the end of the case and answering more questions about non-GAAP financial information, I have learned that disclosure of information outside of the formal financial statements is very important information and should be considered by anyone interested in buying stock in a company. Google's press release had a noticeable impact on their stock price at the time and provided solid evidence that non-GAAP financial information is an important component of stock valuation.

Questions

a) Read the excerpts from the press release and review the operating performance noted in the statements of income accompanying the press release

   i) Consider the table that reconciles GAAP measures to the non-GAAP measures. What explains the difference between GAAP net income and the non-GAAP equivalent? Do you agree with each of Google's adjustments in computing non-GAAP earnings? Why or why not?

      1) The difference between GAAP and non-GAAP is due to five differences that are disclosed in the press release. The differences are related to the elimination of various activities such as stock-based compensation expense, restructuring and related charges, the income tax effects of both aforementioned, and to remove the loss related from discontinued operations. The sum of these changes amounts to the difference between the two amounts. I agree with Google's adjustments because it discloses additional information that is useful in the valuation of the company and other metrics that are useful for investors interested in the company.

b) Use the attached stock market charts for Google

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

      1) Google's stock price change in value around the time that earnings are reported. This would be due to earnings that exceeded or fell short of the expectations set by market analysts. After the first quarter earnings

were reported, price of the stock went up. After the second quarter, prices went down. The prices shot up around the time of the third quarter earnings due to performance that far exceeded expectations. After the release of the fourth quarter earnings, prices dipped but quickly rebounded after the release of the press report.

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

1) For the first quarter, the price performance of the Google stock closely followed the NASDAQ portfolio. During the second quarter, Google surged ahead of the market. The stock priced dipped after the release of the second quarter earnings to roughly match the market level. After the release of the third quarter earnings, Google shot way above the market level and continued to grow at a rate higher than that of the market for the rest of the year.

iii) Based on the stock market chart, did the market perceive the earnings news in Google's press release dated January 30, 2014 as good or bad news?

1) After the release of the fourth quarter earnings, the price dropped for a few days. Then after the press release was put out, the price of the stock rebounded. Due to the increase in the stock price after the release of the press release, it could be interpreted as good news. This press release contained information related to non-GAAP financial measures

that was not disclosed in the financial statements. This newly disclosed information was viewed positively.

c) Read the WSJ article titled "Google Reports Higher Profit"

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

      1) During this period, Google reported \$3.38 billion in income and earnings of \$9.90 per share. Excluding "stock-based compensation and other items", Google's earnings were \$12.01 per share, slightly below the \$12.20 predicted by analysts. Even though Google did not meet earnings expectations, the underlying information that the company disclosed inspired confidence within the investment community that the company's stock still had a market value above what it was trading for at the time. This could be due to the company increasing the number of clicks on their online advertisements or upcoming sale of Motorola.

   ii) What other factors does the article discuss that might contribute to the market's positive reaction to the earnings press release? Are there any other factors that might cause investors to be concerned?

      1) Some of the other factors mentioned that could have positively impacted the positive reaction are the growth in clicks on the company's search advertisements. At the time, some investors were

worried about Google's ability to transition to the coming mobile age. Despite this, the company was making progress in that regard and it seems the market believed they were on the right track. According to other companies, Google was raising prices of advertisements on their search engine which was behind some of the increases in revenue. Additionally, app sales revenue doubled from the previous year and the company disclosed their intention to sell the lagging Motorola brand. A telling sign of the confidence in Google was the fact that after the press release, Google's shares were trading at 13 times their 2013 earnings.