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A Comprehensive Study of Accounting Principles and Applications through Analysis of Case Studies

Guy Freeman

A COMPREHENSIVE STUDY OF ACCOUNTING PRINCIPLES AND APPLICATIONS THROUGH ANALYSIS OF CASE STUDIES

By

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

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ABSTRACT

GUY BARRETT FREEMAN III

A Comprehensive Study of Accounting Principles and Applications through Analysis of Case Studies

(Under the direction of Dr. Victoria Dickinson)

The following thesis is a compilation of case studies that provide a detailed analysis of various financial accounting standards in agreement with Generally Accepted Accounting Principles as governed by the Financial Accounting Standards Board. In concurrence with the topics learned in the Patterson School of Accountancy program, each case focuses on a separate subject of financial reporting through application within specific corporations and dissertations. This thesis explores understanding of accounting principles, financial statement preparation and analysis, current accounting topics, and real-life application for a career in public accounting. Additionally, the thesis work incorporated knowledge from studies in other coursework, such as economics and finance. The case studies were completed under the direction of Dr. Victoria Dickinson in fulfillment of the requirements for the University of Mississippi Sally McDonnell Barksdale Honors College, Patterson School of Accountancy, and Professional Research and Development Thesis Program.

TABLE OF CONTENTS

LIST OF FIGURES

Case 1

Data Analytics and Python

September 5, 2018

Executive Summary:

Prior to starting this case, I barely knew anything about Python other than that it is a multi paradigm, general-purpose programming tool. However, as I began my research, it became evident quickly that Python is the "swiss army knife of coding." This case challenged me to gain a detailed understanding of the Python, including the history of its conception and applications of the program to both audit and tax. Going on its twentieth year of existence, Python is infamous for its versatility and user-friendliness. The program can be applied to nearly any software, such as Windows, Mac OS, and Linux, as well as any operation assignment, such as managing cloud data, constructing websites, and graphic design. Additionally, Python was specifically developed for human readability and is easy to learn for beginners in the coding world. . I found that one of the most impressive and practical features for when I am a first year in the public accounting is that it can take substantial amounts of data, such as scattered numbers on a general ledger, and organize them into excel. This saves accountants hours of time, because instead of taking hours scanning through several documents of data and manually entering into excel, Python can execute the gathering and organization to where accountants are able to focus on making the judgment call. More advantages include how it is constantly upgrading itself and its scalability in that it can carry large amounts of development in a short time. Thus, the program does not indicate it will be going out of date anytime soon and will only continue to aid its users in performing the tedious tasks in data organization.

History and Purpose

Python was founded and created by Dutch programmer Guido van Rossum in 1989. His creation began as a hobby to fill Rossum's free time during the Christmas holiday, and received its name due to Rossum's fandom of the movie "Monty Python's Flying Circus." In 2018, Rossum left the company he created to pursue other goals, but Python continues to be one of the main leaders of high-level programming.

Python is a general purpose programming language, used by thousands of people to do anything from testing microchips at Intel, creating websites and web applications, or reading and interpreting large volumes of data. For businesses, Python's user-friendliness and low cost serve as huge advantages. The syntax rules of the program emphasis code readability, using English keywords more often instead of symbols and punctuations, unlike more complex programming languages. For over a decade, Python has utilized and upgraded a feature called ERP5 (enterprise resource planning), which collects documents and traces its common themes with any custom organization preference. Implementing ERP5 paves the cleanest path for companies to organize their large amounts of data to make a well-informed business decision. Python is also compatible with several programming platforms, contains a vast library of functions for those with specific and custom needs, and supports multiple programming paradigms. These features make code building more readable and straightforward for business people who are not coding experts. Thus, businesses that use Python give themselves a low cost advantage that other programs are unable to provide. Being user-friendly and versatile in its language, companies that use Python do not have to spend a large amount of money to purchase the program or find an expert to train employees. Using Python gives companies the opportunity to decrease labor costs and allocate their time towards other priorities in their business decisions.

Utilizing Python in Auditing

I would use Python in auditing firstly by taking advantage of its ERP5 system, which can review and verify financial statements for accuracy and credibility. Its workflow foundation can specify purchase accounts, sales accounts, or any other accounts in any desired order, while justifying them with company records and transaction history. The program is capable of exploring and analyzing large amounts of data and can organize complex financial information in a straightforward fashion. Its multi-currency feature gives users accurate tracking of international balances grouped together, and its asset management can automatically use life cycle data to estimate amortization on both original and transferred assets. Auditors at large public accounting firms could particularly benefit from the program due to the large amounts of data they are assigned to manage.

Another way I would take advantage of Python in auditing is by creating programs that aid in detecting common mistakes in financial records. More common auditing mistakes include failing to apply Generally Accepted Accounting Principles (GAAP) and making small mathematical errors and misestimates. GAAP requires auditors to complete their work in specific ways. Easy ways to fall into repetitive errors in adhering to GAAP regulations include double checking records with industry experts when it comes to specific issues, covering expansive and informative accounting topics, and presenting information fairly and honestly. I would use Python to write a code that automatically implements and checks for GAAP standards. Gathering a large quantity of data, paying attention to small details, and due care also come as challenges for auditors. For instance, transposition errors are common, and can be detected by subtracting the difference and dividing to see if the outcome is divisible exactly by nine. Errors such as these can take a long time to identify and correct, but a Python program can catch mistakes such as these immediately.

A third way I would take advantage of Python in auditing is by creating a program that can take past financial data to predict future trends in different industry sectors such as banking and insurance. Banking internal audit relies on commercial value in fraud detection, risk management assurance, and sound professional advice. Auditors in banking must be thoughtful and proactive in predicting the trends of the next economic cycle, a job that fits perfectly for Python. Python code can be written to detect where there is most potential for fraud and estimate where there will be the most risk with the corresponding economic cycle, as well as using data from the past. Insurance facilitates societies and economies to function efficiently, and is a form of risk management used to hedge the risk of loss. Python programming can use statistics and probability to approximate the rate of future claims and losses. Usually in internal insurance auditing, underwriters adjust rates manually based on subjective information, but Python can take volumes of past data to identify where there is a greater chance of financial risk.

<u>Utilizing Python in Tax Planning</u>

The purpose of tax planning is to ensure tax efficiency, specifically in reducing tax liability and maximizing contribution to successful retirement plans. If I were working in tax planning, I would feel immense pressure in having to constantly maintain and strategize the best scenarios for individuals and businesses, thus I would use Python to create a program that could help me find the best possible scenarios. Identifying timing of income, size of company or occupation of individual, standing of the economy, and planning of other expenditures all factor into tax filing, and Python programming could compile all the data to create a best possible scenario for an individual or company.

I would additionally use Python in tax planning to calculate the amount of taxes that my clients, whether individual people or businesses, should be charged. It can be challenging to keep up with numerous clients with different backgrounds, occupations, and locations. Also, there are several rules and regulations that are enforced by the Internal Revenue Service (IRS) and the federal law. Using Python, I would create a program that would calculate taxes for clients so that I would not have to configure them myself. Pairing a tax calculation program with another program that contains all IRS rules and regulations would benefit me even further so that I would not have to laboriously ensure taxes were according to IRS standards. Python would greatly aid in taking heavy workload off of tax calculations and checking for IRS standards, thus allowing me to allocate my time elsewhere.

A third scenario where Python would greatly benefit me in tax planning is in avoiding underpayment penalties in tax returns. In filling out tax returns, miscalculating how much to pay to the IRS is a common mistake, as well as costly. The IRS distributes Form 1040ES to help in determining the estimated amount of tax required to pay or withhold, but writing a Python program could estimate the amount faster than any human. Python programming could take into account W4 withholdings and IRA distributions, as well as user demographics such as age, location of living, and profession.

A custom Python program could calculate how much an individual must pay, when his money is due, and how to avoid withdrawal or tax return errors.

<u>Implementing Python in My Company</u>

To: The Firm

From: Barrett Freeman

Date: September 5, 2018

Subject: Python Implementation

To whom it mat concern within the firm,

Our team should invest heavily in implementing Python at our company due to its voluminous data management, user-friendliness, and ability to reduce costs. Python can hold an abundance of financial information from balance sheets, income statements, and statement of cash flows. It can compare past and present data, economic condition, and historical trends to make the best estimations that predict the future. Python would greatly benefit our company in giving our employees an organization and prediction tool that cannot be replicated by their own work, which gives them opportunities to allocate their energy elsewhere.

Learning Python coding does not require a huge investment in training or teaching complex computer programming. With the proper attention our team could be writing Python code in weeks. Instead of using complex symbols and figures, Python code uses English letters to make writing code as straightforward as possible. Ultimately, implementing Python at our company would greatly cut costs. Instead of using a large amount of money, time, and energy in managing data, configuring best estimates, and detecting complex errors, our employees could develop their own Python code to solve both their daily struggles and troubling long term assignments.

Thank you for taking the time to read my letter. Please do not hesitate to reach out if you have any questions.

Best,

Barrett Freeman

Case 2

Rocky Mountain Chocolate Factory, Inc. - Statement of Cash Flows

September 12, 2018

Executive Summary:

In this case, I analyzed transactions and events from Rocky Mountain Chocolate factory and recorded them into various financial sheets, including a general ledger, income statement , balance sheet, and statement of cash flows. In order to complete the assignment, I had to understand how these financial statements were formatted and the important information they convey to financial users, including investors, creditors, and company managers. Prior to this assignment I understood merely the basics of excel; but after completing this case I gained confidence in navigating excel, including creating various cell formulas and formatting financial statements. I learned the value of creating equations to reach my desired outcome rather than having to spend an unnecessary amount of time manually inserting numbers. For instance, instead of manually typing the total liabilities and equity number, I was able to create a formula that automatically calculates total assets and liabilities. Thus, when checking to ensure total liabilities and equity equal total assets, I was able to confirm the figure was correct due to the accuracy of the line items in the balance sheet rather than my mere ability to manually copy data into excel Additionally, I enjoyed this case because it was great practice for the type of work I will be doing my first few years of public accounting. Of course, I will not be recording the financial statements, but I must be confident in my ability to process financial information and draw conclusions from the data presented.

a. Prior to examining the company's actual balance sheet, read the description of Rocky Mountain Chocolate Factory, above. What accounts do you expect to see on the balance sheet? Which accounts constitute the major assets? Which accounts constitute the major liabilities?

On the balance sheet, I expect to see assets, liabilities, and owners equity, including revenues and expenses. The major asset accounts include cash and
cash equivalents, inventories, accounts receivable related accounts, and property plant and equipment. The major liabilities accounts include accounts payable,
accrued salaries, and other accrued expenses.

b. Based on the transaction recorded, list at least three major adjustments or reclassification that might need to be made prior to preparing the final financial statements?

Rocky Mountain Chocolate Factory will make several adjustments at year end, including adjusting accounts such as accrued salaries and wages, depreciation and amortization, and inventories. The year-end general ledger for Rocky Mountain Chocolate Factory's adjustments is presented on the next page:

Figure 2-1: Rocky Mountain Chocolate Factory General Ledger

General Ledger			
1	Inventories	$7,500,000	
	Accounts Payable		$7,500,000
2	Inventories	$6,000,000	
	Accrued Salaries and Wages		$6,000,000
3	Cash	$17,000,000	
	Accounts Receivable	$5,000,000	
	Sales		$22,000,000
	Cost of Sales	$14,000,000	
	Inventories		$14,000,000
4	Accounts Payable	$8,200,000	
	Cash		$8,200,000
5	Cash	$4,100,000	
	Accounts Receivable		$4,100,000
6	Sales and Marketing	$1,505,431	
	General and Administrative	$2,044,569	
	Retail Operating	$1,750,000	
	Cash		$2,000,000
	Other Accrued Expenses		$3,300,000
7	Accrued Salaries and Wages	$6,423,789	
	Cash		$6,423,789
8	Cash	$125,000	
	Deferred Income		$125,000
9	Property, Plant, and Equipment	$498,832	
	Cash		$498,832
10	Retained Earnings	$2,407,167	
	Dividends Payable		$3,709
	Cash		$2,403,458
12	Cost of Sales	$216,836	
	Inventories		$216,836
13	Depreciation and Amortization	$698,580	
	Property, Plant, and Equipment		$698,580
14	General and Administrative	$639,200	
	Retail Operating	$6,956	
	Accrued Salaries and Wages		$646,156

c. Rocky Mountain Chocolate Factory Income Statement

Figure 2-2: Rocky Mountain Chocolate Factory Income Statement

Rocky Mountain Chocolate Factory Inc. Income Statement FPE February 28, 2010	
Revenues:	
Sales	$22,944,017.00
Franchise and Royalty Fees	$5,492,531.00
Total Revenues	$28,436,548.00
Cost and Expenses:	
Cost of Sales	$14,910,622.00
Franchise Costs	$1,499,477.00
Sales and 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 Expense	$0.00
Interest Income	$27,210.00
Other, Net	$27,210.00
Income Before Income Tax	$5,670,545.00
Income Tax Expense	$2,090,468.00
Net Income	$3,580,077.00
Basic Earnings per Common Share	$0.60
Diluted Earnings per Common Share	$0.58
Weighted Common Shares Outstanding	$6,012,717.00
Diluted Effect of Employee Stock Options	$197,521.00
Weighted Average Common Shares Outstanding, assuming Dilution	$6,210,238.00

d. Rocky Mountain Chocolate Factory Balance Sheet

Figure 2-3: Rocky Mountain Chocolate Factory Balance Sheet

Rocky Mountain Chocolate Factory Inc. Balance Sheet As of February 28, 2010	
Assets:	
Current Assets:	
Cash and Cash Equivalents	$3,743,092
Accounts Receivable	$4,427,526
Notes Receivable, Current	$91,059
Inventories	$3,281,447
Deferred Income Taxes	$461,249
Other	$220,163
Total Current Assets	$12,224,536
Property and Equipment, Net	$5,186,709
Other Assets:	
Notes Receivable, Less Current	$263,650
Goodwill, Net	$1,046,944
Intangible Assets, Net	$110,025
Other	$88,050
Total Other Assets	$1,508,669
Total Assets	$18,919,914
Liabilities and Stockholder's Equity	
Current Liabilities	
Accounts Payable	$877,841
Accrued Salaries and Wages	$646,156
Other Accrued Expenses	$946,528
Dividend Payable	$602,694
Deferred Income	$220,938
Total Current Liabilities	$3,294,157
Deferred Income Taxes	$894,429
Commitments and Contingencies	$0

Figure 2-3 cont'd: Rocky Mountain Chocolate Factory Balance Sheet

Rocky Mountain Chocolate Factory Inc. Balance Sheet Continued As of February 28, 2010	
Stockholder's Equity	
Preferred Stock, $.10 par value; 250,000 authorizes	$0
0 shares issued and outstanding	$0
Series A Junior Participating Preferred Stock, authorized 50,000 shares	$0
Undesignated series, authorized 200,000 shares	$0
Common Stock, $.03 par value; 100,000 shares authorized	$180,808
Additional paid-in-capital	$7,626,602
Retained Earnings	$6,923,927
Total stockholder's equity	$14,731,337
Total Liabilities and stockholder's equity	$18,919,923

e. Accrued salaries and wages, other accrued expenses, and deferred income will need to be adjusted.

f. Cash Flows Classification answers:

1. Operating
2. Operating
3. Operating
4. Operating
5. Operating
6. Operating
7. Operating
8. Operating
9. Investing

10. Financing
11. N.A.
12. Operating
13. Investing
14. Operating
15. Investing

Case 3

Public Accounting Student Ethical Scenarios

September 19, 2018

Executive Summary:

For Case #3, our class was given three different scenarios involving common struggles and current interests for accounting students around the country. The issues were not simply constructed out of imagination, but are tough decisions hundreds of accounting students face and must at some point make a decision. After acting out each scenario, the class would choose between two different viewpoints and then debate their stance. From this in-class case, I learned a ton of practical knowledge that I need as I prepare for recruitment for public accounting. For instance, after doing the calculation in class, I had no idea that it took over two years (specifically 2.33 years) for a firm to start profiting off a new staff member. I learned that when a firm offers an intern, they are taking a risk on that intern not only based on performance, but also based on if he or she will stay committed to the firm. A student that declines their full time offer after their internship hurts both the firm in that they are losing money off of an investment, as well as the intern's school reputation. This is only one of the examples of the many conversations spurred from this exercise. At the end of our discussions, the class gained several different perspectives on various topics in accounting education, as well as being challenged to consider their individual beliefs on the subject matter. Below are the three scenarios followed by my individual thoughts on them.

Scenario 1: Two students who are accounting majors are studying in Connor and strike up a conversation about their career paths. Student 1 is explaining how he is determined to use his accounting degree to get into a prestigious law school and make a high salary in tax law, like his older cousin who works in New York. Student 2 is concerned about if Student 1 will be wasting the accounting firm's time with recruitment and his internship senior year, but Student 1 looks to stick with the internship, claiming it will give him beneficial experience.

My response:

I greatly relate with Student 1 on this issue, in fact, I am considering law school and a career in law. I believe with an accounting degree, a manufacturing minor, and a law degree there would be an abundance of opportunities in the job market. Now, I do not want to practice law merely to make a lot of money, such as Student 1 expresses as his ambition, and I am leaning more toward civil law rather than tax law. But I see where he is coming from in that he wants to complete his accounting degree with the accounting internship in order to build his resume and broaden his work experience.

I believe if Student 1 is one hundred percent sure he will practice law the rest of his life, he needs to consider finding an internship at a law firm rather than an accounting firm. The accounting firms, specifically the "Big 4," hire interns with the purpose of grooming them into working for their firm long term after college. It would be unfair to both himself and the firms to take an accounting internship when he is fully intending not to work in the accounting profession.

However, many students, similar to myself, are not 100% sure if they are driven towards working in the accounting field. They might be looking forward to the accounting internship so that they can get a taste of the job and see if they enjoy it. Naturally, the question of transparency arises. Should a student who is considering law school disclose that information in interviews? I believe, while transparency is valuable, correct, and a character trait of integrity, in job interviews, there should be transparency only to a certain degree. In a job interview, the firms are not obligated, and thus do not inform the potential worker of everything, from the success to the severe problems, of the company. Similarly, a student in an interview is not obligated to full disclosure of his thoughts, such as that he is not sold on accounting. At the end of the day, the student, like every other person and business, must chase after what he believes is best for himself. While an accounting firm would indeed take a financial loss from a student who works for them in an internship but then does not work for them full time, that student does not have an obligation to operate around other businesses needs, such as a business is not obligated to center its operations around a business's personal needs.

Scenario 2: Three students are engaging in a conversation in Connor Hall while walking to class. All of them are pursuing an accounting degree, but two of them have made up their minds that they do not want to be accountants. One of them wants to go into banking, the other wants to get her MBA and then go into consulting. Thus, the conversation leads to a debate in if the two girls who do not want to be accountants should get a degree in a different field.

My response:

Once again, I relate with the two girls who are pursuing an accounting degree without necessarily wanting to be accountants. An accounting degree is one of the best degrees that one can earn in school. Accounting is the language of business, and the versatility of the degree enables one to perform several jobs that people with simple business or marketing degrees cannot perform.

Similar to many others, I do not have my life planned out, nor do I fully know where I would like to be in my occupation in the future. I believe that one should absolutely be able to get an accounting degree even if he or she does not want to be an accountant. In fact, I am positive that several accounting majors who think they want to be accountants in college will want to find another business job later in life. If students such as the two in this scenario are 100% positive they will not go into accounting, they should find internships other than the accounting internship, because the students should not waste their time in accounting, and the firms should not waste their time in training students who do not desire to work in accounting. Otherwise, accounting students who are unsure about what field in which they desire to work should absolutely participate in being recruited and working for the firms in an internship. By interning at the firm and gaining work experience, accounting students receive an opportunity to learn more about their degree and their working preference for the future.

Scenario 3: A student worked in Washington, D.C. for his internship, and was offered a job with the firm out of college. However, he emailed Dr. Dickinson shortly after completing his internship, asking for help in getting the offer transferred to the Dallas firm due to his desire to move back closer to home. Dr. Dickinson responded to his email, stating that getting transferred to Dallas is possible, but not likely, and additionally gave him direction in talking with his recruiter. The student responded in an appreciative way and still looks to transfer his job offer to Dallas.

<u>My Response:</u>

It would be easy for me to respond and argue something along the lines of how the student should have thought ahead and chosen his internship location more wisely. However, at the end of the day life gets tricky, and hindsight is a luxury everyone wishes they possessed. I have no information about the student's situation and reasoning he sought to transfer his offer closer to home in Dallas. I sympathize with them in that he wishes he could successfully be transferred back home. Unfortunately, life is not as smooth and as Dr. Dickinson stated in her email, while being transferred is possible, it is also very unlikely.

If I were the student, the first thing I would do is contact everyone I knew, from people at the Dallas firm, the D.C firm, to the recruiter from college. I would ask them for advice, and it seems as though he already did this by how he reached out to Dr. Dickinson. If I were unsuccessful, I would take a deep breathe and consider other possibilities, such as completing the obligation of work for the contract I signed, and then trying to go home. Additionally I would look for positive aspects of Washington D.C., and I would look to network with different people and explore new opportunities. From this scenario, my most significant takeaway is to go ahead and start researching different job opportunities and become well informed about different job locations. Reaching out to various firms, visiting different cities, and researching different accounting professions today will all contribute to setting myself up for the best internship experience.

Case 4

Generic Bank - Accounting for Debt Securities Sales and Impairments

October 3, 2018

Executive Summary:

Case 4, presented to our class by Dr. Brett Cantrell, introduces Generic Bank and its accounting situation with debt security impairments. In the case, the bank considers the benefits and risks of selling its debt securities for liquidity purposes. The questions in this case present different perspectives from various leaders involved with Generic Bank, which gives the student the task in making judgment calls on financial reporting. Before this case, I had assumed there was a general impairment rule that every company could generally follow in order to apply the proper accounting treatments. However, in completing this case I learned that there is not one universal procdure for impairment losses and every situation must be inspected differently. Another aspect of this case I enjoyed is that it simulated realistic situations that would likely happen in public accounting in somewhere such as an audit room. Auditors must be able to effectively gather data in a detail-oriented work ethic in order to critically reason the proper conclusion for any individual scenario. Additionally, this case reminded me it is highly important to understand the accounting standards, official procedures, and formal regulations that go into different line items on the financial statements such as impairment loss. Writing this case has caused me to have a greater appreciation for all of the time and energy that auditors invest in order to properly account for impairment losses in any given circumstance.

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

During 20x2, Generic Bank did obtain an impairment loss after selling the seven securities. An impairment loss occurs when an asset's carrying amount exceeds its recoverable amount. Thus, the assets lose their value to be held by a company. Joshua Winters, CEO of Generic Bank, sold seven securities for an increase in cash of $331,835,000, but also realized a loss of $54,209,000 into earnings. Table 2 shows the Generic Bank AFS Security Detail by Asset Class, which lists all 100 of Security Types, including their description, amortized costs, and fair value in 20x2. The seven securities sold were numbers ending in 003, 015, 025, 030, 067, 076, and 096. Of those 003, 025, 030, and 076 had a significantly higher amortized value than fair value, averaging an increase of almost $20,000. The other three securities, 015, 067, and 096, held a higher fair value than amortized cost, but with only a slightly higher value averaging just over $1,400. The slightly higher amount in fair value does not justify the significant amount of amortized cost. A loss overall will be incurred over time on the seven securities being sold, even though Generic Bank might have obtained a higher liquidity value for the present day. In order for me to be successful in the accounting profession, I will have to be able to analyze different scenarios, often new or unpredictable, and be able to effectively reason given limited facts and reach a conclusion.

2. Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 20x3. Does Generic Bank have an impairment loss on securities

other than the seven securities sold? If so how would you determine the extent of the impairment?

Generic Bank would not have an impairment loss on the remaining securities that were not sold, because there is no concrete way in determining what the loss would be while the bank is still holding the securities. Even though the amortization costs exceed the fair values in total for the securities, it is impossible to determine how their value would develop over time. Securities could continue to deteriorate in cost, or recover in value. As the case explains, security impairments are complex and based off of subjective standards and future economic events. While securities are still being held, there is not a clear method in deciding if securities will be impaired. Generic Bank believes that impairment is related more to interest rates than credit deterioration, and interest rates fluctuate over time and can be difficult to predict. Without knowing how the securities will mature or how the economy will change in the future, Generic Bank is unable to determine an impairment loss on the other securities.

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

Even with an external auditor, a loss on the securities could still not be determined. Herring's role as an external auditor is to verify that there are no misstatements in Generic Bank's financials, and assuming Generic Bank is following proper GAAP and FASB standards, an impairment loss still could not be concretely determined due to there being no clear way in figuring out what value the securities would hold in selling them today. Some auditors might determine an impairment loss, while other do not determine an impairment loss, depending on how they conduct their audit. A bank regular would likely not want to report an impairment loss on the securities. If the bank is still holding the securities, they still could recover and regain or even exceed in value. Thus, a bank regulator would hold out in reporting an impairment loss, until it actually comes time to sell the securities and he has to report their value on a factual basis. FASB does not have detailed rules about reporting an impairment loss before selling securities. A bank regulator and external auditor should further consider other financial information of Generic Bank such as the amortized cost of investment securities, and their unrealized gains and losses that lead to their estimated fair value.

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

Assuming the securities were sold collectively in a net gain position, there would not be an impairment loss present. In requirement 1, an impairment loss was determined based off individual securities' significant rise in their amortized cost from their fair value. Without the securities being individually analyzed and instead selling all of them collectively, there would be no need to find and report an impairment loss. If the securities were sold in a gain position, then an impairment loss would occur, and would simply be reported as a gain on the income statement.

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

In this scenario, Generic Bank does have an impairment loss on the securities other than the seven securities sold. Generic Bank is only adequately capitalized instead of well capitalized, and they desire to sell securities to meet their liquidity needs. According to FASB 320-10-33B, if the entity needs to sell the securities before recovery of their amortized cost, a permanent impairment loss must be reported.

Case 5

Personal Career Analysis

November 7, 2018

Executive Summary:

For Case #5, students were required to identify their top two cities in which they would prefer to star their career out of college. Using a list of seventeen questions, I researched my two cities of preference, Nashville and Birmingham, and created a thorough analysis of each living situation. The goal of the case was for students to become more informed about their cities of preference, while also providing useful thinking topics that need to be carefully thought through prior to the official start of the recruiting process. Below is my analysis of my two cities.

City #1: Nashville, TN

Nashville, TN's 2017 population was 667,560 people. The city falls under the humid subtropical classification and is located in the southeast. Their climate includes all four seasons, but winters are short not harsh. Summers are long, hot, and humidity can be high. Thus, precipitation can also be high.

Nashville is renowned for its music-centric attractions and beautiful scenery. The Grand Ole Opry, Country Music Hall of Fame, and the Parthenon are only a handful of its famous attractions. Additionally there are several concert venues, the professional sports teams, and historical landmarks or museums, and downtown life. The majority of residents drive their own vehicles to work. There is a bus system called the Metro Transit Authority, as well as a commuter rail called the Music City Star. Thus, Nashville residents have many options in their choice of transportation. Learning various

Nashville's Grand Ole Opry

ways to navigate Nashville is important because, like any city, there are dangerous areas that one should either avoid or be cautious of various dangers. Downtown Nashville is prone to crime, where the most assaults happen in the city. East Nashville is another dangerous place to live, which is a twelve square mile area located cradled within a bend of the Cumberland River. The most robberies and car thefts in the city happen in this area. Off of Nolensville road, there is a twenty-four square mile area that averages around 100 a month, including burglary, assault, and robbery.

Assuming I would start with a salary of around $50,000, I would have to pay around 17 percent federal tax, and no state tax due to Tennessee laws. Omitted state tax is a huge advantage, and this only brings my salary down to around $41,500 rather than a larger amount. Other taxes such as property would vary, and I would be careful to choose a smart living situation that is not expensive, such as an apartment. Education and Health Services controls over a fifth of major industries in Nashville, followed by automobile production, and the third most prevalent being a mix of music production and tourism. Being the hub of the health services, the city's healthcare is among the best. In 2015, its economic contribution was $38.8 billion, supporting over 249,000 of local jobs. There are more than 400 healthcare companies located in the city, with over $940 million invested in healthcare companies by venture capital firms.

In my first few years of working, I plan on renting an apartment with another person if I work in Nashville. An example of the type of an apartment I that I would live is the Views On The Cumberland. The cost of living is $850 a month,

The Views on the Cumberland

and I would have one or two roommates living with me in a two or three person bedroom. Its location is right by the major highways and not far from downtown where I would be working. Their most popular, “VOTC II 2 Bedroom,” is just over 1000 square feet, which includes the cost of utilities. Though rent is more expensive than average, the apartment is fully furnished and provides all of my basic needs such as a kitchen, a bathroom, a washing and drying machine, internet connection, and even a parking lot. The apartment is at a great location and only around a twenty to thirty minute commute to work everyday, depending on traffic and assuming my office is around downtown Nashville. Traffic can become an issue in the city, but in only rare conditions would I sit in traffic for more than forty minutes to get to work, since I am not living on the outside of the downtown area. Thus, my location is around many convenient retail stores, grocery stores, and even restaurants, so I will not have to go out of my way for any basic needs. I will drive myself to places such as work and stores, and if there are special occasions such as a football games or a concert, there is transportation such as taxis and services available.

One of my priorities once I settle in would be to get involved with the city of Nashville. There are countless ways to enjoy and participate the community, which makes Nashville unique. There are two churches in particular, Cross Point Church and Downtown Presbyterian Church, that I would look forward to visiting, but there are several different churches that I would like to visit before eventually being routinely involved in one of them. Another way I would like to get involved is by running different races, such as 5k runs. Courses often weave through the city and would be a great way to both meet people and learn more about my new home. Further I would be interested in getting involved with United Way, an organization that strengthens the community in education, financial stability, health, and cleanliness. They could guide me in direction that best enables me to serve the community.

If I lived in Nashville, I would never run out of activities outside of work. There are several sports venues including the Tennessee Titans, Nashville Predators, and even Vanderbilt football games I can attend every other year when they play Ole Miss. Several restaurants such as the Bluebird Cafe feature live music of amateur artists, and there are also grand concert halls for famous artists such as the Grand Ole Opry and the Ryman Auditorium. There are historic museums such as the Parthenon, and the more modern museums such as the Country Music Hall of Fame. No matter what, the downtown life, such as music row, and various parks, such as Centennial Park will always be available for me to enjoy no matter what day. Traveling home would not be difficult if I lived in Nashville. Memphis is straight down Interstate 40 and at most a four-hour drive, and it would not even take a full tank of gas.

The table below (starting on the next page) represents my estimated budget for my second year of living in Nashville, assuming my salary increased to $60,000. Highlights include keeping 25% of my income in my savings account, keeping an emergency fund in case needed, and a gift fund for friends and family. The excess money will be kept in my savings account, unless another expense arises.

Nashville Cost of Living

Figure 5-1: Nashville Cost of Living

Object	Per month	Yearly total	Grand total
Salary			60,000
Federal Tax		8,500	
Rent Expense	850	10,200	
Car Insurance	100	1,200	
Healthcare	500	6,000	
Gas	120	1,440	
Groceries	150	1800	
Emergency	200	2,000	
Savings	1,250	15,000	
Gift	100	1,200	
Spending	600	7,200	Less: 51,540
Total Remaining			8,460

City #2: Birmingham, AL

Birmingham's population is around 210,710 people. The city is in the humid

subtropical climate classification, having an average temperature of 64 degrees Fahrenheit. Winters tend to be short and mild, while summers can be very hot, and the state of

Alabama is ranked second in the U.S. for deadliest tornadoes. As the largest state in Alabama, Birmingham is a beautiful historic destination and boasts a wide range of exciting attractions and venues. Their signature destinations are the Barber Vintage Motorsports Museum, Museum of Art, Civil Rights Institute, and Vulcan Park. Their culture includes southern cooking, jazz bars, and several parks that escape the city life. While Birmingham, similar to Nashville, holds a wide variety of transportation services including bus services, Amtracks, and taxis, the vast majority of people travel within the city using their own vehicles.

Tax rates within the city start with a federal tax that is around 15-20 percent, and then a state tax that is around 5 percent on income. Thus, if I started with a salary of $50,000, that would drop my income down to around $38,000 before other taxes. Alabama holds the eight highest sales tax rate of 8.45 percent. After property taxes, which would hopefully be low due to living in an apartment, and since I would not own a pet or hold any type of license such as hunting out of college, thus my salary would most likely fall within the low $30,000s. The city's major industries are steel, financial services, and telecommunications. Birmingham's healthcare, the Alabama Regional Medical Services, has served the area since 1983 and offers a variety of different plans. One of their healthcare's strengths is that they are intentional in reaching out to the community and with those who are homeless or are in great financial need. The UAB School of Medicine is located in the center of the city, which attracts people from all over the country in enrollment for medical studies and research.

There are three places in particular that one should be careful to avoid when commuting through Birmingham. Located just off of Interstate 20, Druid Hills is home of

2,198 residents living in mostly dilapidated homes with a median income of $15,826. This part of the city is known for the most counts of burglary, shootings, and assaults. Home to the second highest crime rate is the Airport Highlands, located near downtown. However, the farther away from downtown, the farther one gets away from the areas of the city that are the worst in crime. The cost of living in Birmingham can be notoriously high in places like Vestavia Hills and Mountain Brook; however, I would not live in these expensive places starting out of college. Rather, I would live in a place like The Park at Buckingham, located in Aspen Circle. The apartment homes are safe and guarded with a gate, and the one bedroom, one bathroom apartments come fully furnished, 1000 square feet, at $754 a month. Thus, I would not need to find a roommate, and the apartment comes with many great features such as a working facility and an outside pool, and there are plenty of parking spots available. Each home features its own wifi connection, refrigerator and laundry room, but I would have to provide my own bed.

Assuming I were to live at the Park Buckingham Park Apartment Homes, I would get on interstate 65 and drive North in my commute to work everyday. A regular drive to work would be around twenty minutes, but rush hour usually almost doubles commute times to forty minutes. Being from Memphis, I am used to rush hour traffic, so an hour round trip to work is nothing new for me. There are shopping centers and grocery stores scattered throughout the city of Birmingham, and would not need to drive very far to find all my basic grocery needs at stores such as Kroger and Target. My farthest drive would be when I go home to Memphis. Though all I have to do is stay on Interstate 22 Northbound, it is almost a four-hour drive to where I live. Spanning around 250 miles, the drive would take up a significant portion of my gas tank, but compared to other cities for which I could work, the drive home is relatively short

The first church that pops into my mind that I would like to attend in Birmingham is Faith Presbyterian Church. The pastor, Jason Sterling, is the former Ole Miss RUF campus minister. A prior Alabama football player started a home in which I would like to serve called Big Oak Ranch, a place that gives abandoned and abused children a safe place to live in an orphanage setting. Another great opportunity to get involved with giving back to the community would be serving with Jimmie Hale Missions, a ministry that provides meals and clothing to the homeless. There are also several different attraction and venues to explore in Birmingham. Some of the best hiking trails are found near Birmingham at Oak Mountain State Park, along with several other parks to visit. Birmingham's Robert Trent Jones Golf trail, the largest golf course construction project, features Oxmoor Valley with three courses and fifty-four holes. If friends are in town though or if I am looking for something cheaper, I could check out Topgolf, a relatively new attraction in Birmingham that features swinging golf balls at targets, along with other various arcade games. The sports venues in Birmingham include the Samford Bulldogs for football, Birmingham Barons for minor league baseball, and the SEC baseball championship every year, which is located in Hoover, which is not too far from Birmingham. Many people also find fun outdoors by kayaking down the Cahaba River, one of Alabama's most scenic rivers that stretches over 194 miles.

Below is an estimated budged for my cost of living in Birmingham, assuming I earn a raise in my second year and my salary increases to $60,000 per year. Highlights of my Birmingham budget includes a higher gas allowance due to a longer travel home, and a state tax account, which is not charged in Tennessee, my home state.

Birmingham Cost of Living

Figure 5-2 Birmingham Cost of Living

Object	Per Month	Yearly Total	Grand Total
Salary			60,000
Federal Tax		8,500	
State Tax		3,000	
Rent Expense	754	9,048	
Car insurance	100	1,200	
Healthcare	400	4,800	
Emergency Fund	200	2,000	
Savings	1,250	15,000	
Gift Fund	100	1,200	
Gas	160	1,920	
Groceries	150	1,800	
Spending	600	7,200	Less: 53,868
Amount Remaining			6,132

After thoroughly analyzing and researching both cities, while I appreciate Birmingham for its outdoors culture and atmosphere, I learned that I would rather work in Nashville starting my career out of college. As the state's capitol, there are several advantages to living in Nashville. Primarily, Nashville is a financially smart decision. There is no state tax that would be deducted from my salary, and it is a shorter drive home than Birmingham. I am also highly interested in the music industry, and would love to work long-term with various companies that work with artists, songwriters, and entertainment productions. The city continues to grow in size and wealth, and is a fantastic central location from other cities such as Memphis, Chattanooga, Louisville, and Knoxville. In addition, I was reminded of the reality that the cost of living is expensive. There are several expenses such as tax rates, health and car insurance, and rent charges that I must strongly consider in choosing a place to live after college.

Case 6

WorldCom, Inc. – Capitalized Costs and Earnings Quality

November 16, 2018

Executive Summary:

For Case #6, the class was given a case about WorldCom, a once large telecommunications company, but became the topic of the biggest accounting scandals in the history of the United States. In order to meet the public's projections and expectations, they manipulated their financial statements to make it appear their company was healthy and receiving a successful amount of cash inflows, but in reality WorldCom was losing hundreds of thousands of dollars. The case challenges students to initially distinguish between costs that should be capitalized and costs that should be expensed, and then analyzing the fraud committed by WorldCom and comparing them with GAAP standards. Overall, the case solidifies the vast importance in ethical and honest accounting. Below are a list of questions and answers pertaining to the case.

a. FASB Statement of Concepts No. 6 (a replacement for SCON No. 3), Elements of Financial Statements, describes the building blocks with which financial statements are constructed.

i. Explain, in your own words, how SCON 6 defines "asset" and "expense.":

An asset, reported on the balance sheet, is a likely future economic benefit that will reap utility for the controlling party. They are something a company owns resulting from past transactions or events. Expenses are the cost of doing business. They are the outflows of providing usage for an asset, which results in a liability for a company. An accumulation of liabilities can come from activities such as delivering or producing goods, providing services, or conducting activities that are woven with the company's ongoing operations.

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

Costs should be capitalized when they are incurred to achieve greater future benefit. One of three conditions must be met: the asset's useful life must be increased, the quantity of units produced from the asset must be increased, or the quality of the units produce must be enhanced. Otherwise, costs should be expensed when they are simply enabling activities in operations to continue in its baseline degree of service. No economic value can be measured in expenses

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

After a cost is capitalized, it moves to the balance sheet as a fixed asset, and is amortized or depreciated over a number of years, depending on if it's accounted for as tangible or intangible. The capitalized cost should meet the matching principle, when revenues and recognized in the same time period as its expenses incur. This impacts the entire financial standings of the company. On the balance sheet, this will increase the amount of assets in the accounts, leading in an overstatement of what should actually be reported. The increase in assets comes from capitalizing the costs, which will lead to an understatement in expenses on the net income statement. Therefore, the ending amount for net income will be more than it actually should be in reality.

c. 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.

For December 31, 2001, WorldCom reported a line cost of $14.739 million in the expense section of their statement of operations. This number suspiciously turns out to be the exact same as the line costs at the end of the year in 1999. According to the case, a line cost expense is essentially access and transport charges. They represent the day-to-day fees that the company paid to third party providers in order to gain permission to use their network materials, but beyond that WorldCom did not provide any more details. Appropriate entries for line costs would be as follows (in millions):

5/10/01	dr. Line Cost Expense	$4,911	
	cr. Cash		$4,911
8/28/01	dr. Line Cost Expense	$3,012	
	cr. Accounts Payable		$3,012

Under GAAP standards, line costs must be expensed, as seen in the example journal entries above. However, WorldCom capitalized the expenses as their own asset on the balance sheet, which lead to an understatement in expenses, and overstatement in earnings, and fraud on their statement on operations.

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

Improperly capitalized costs at WorldCom were the line costs, which are expenses that are telecom access and transport charges in relation with third party network providers and their materials. These costs, which amounted to more than $3.8 billion, should have been accounted for as expenses, not capitalized. WorldCom had planned to amortize this amount over a period of time up to ten years instead of properly charging the cost as an expense on the net income statement. Thus, their net income was higher than it actually should have bee, leading to misinforming their investors in order to meet expectations. These costs do not meet my definition for an asset, because the line costs alone did not provide future utility for the company. Rather, the line costs were a part of the services rendered in order to carry on the daily operations of the business, which meet my definition for an expense.

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

The incorrect journal entry to lead to the misleading of capitalizing costs would be as follows:

12/31/01	dr. Property, Plant, and Equipment	3.055 billion	
	cr. Line Cost Expense		3.055 billion

On the balance sheet, this appears under the assets section in the property, plant and equipment account. On the statement of cash flows, this will appear in the depreciation and amortization account, since the capitalized cost will be charged over a number of years relating to its useful life and revenue.

f. In a sworn statement to the Securities and Exchange Commission, WorldCom revealed details of the improperly capitalized amounts (in millions) in 2001: $771 in the first quarter, $610 in the second quarter, $743 in the third quarter, and $931 in the fourth quarter. Assume that WorldCom planned to depreciate these capitalized costs over the midpoint of the range for transmission equipment as disclosed in note 1. Further assume that depreciation begins in the quarter that assets are acquired (or costs capitalized). Calculate the related depreciation expense for 2001. Prepare the journal entry to record this depreciation.

The depreciation expense for each quarter in 2001 can be calculated by taking the capitalized amount and dividing it by the depreciation rate, and then multiplying that number by the time period for which the amounts are outstanding, measured in quarters. The depreciation rate is 22 years. Below are the calculations (in millions):

First quarter: (771/22) x 4/4 = 35.045

Second quarter: (610/22) x 3/4= 20.795

Third quarter: (743/22) x 2/4 = 16.886

Fourth quarter: (931/22) x 1/4 = 10.58

These four numbers are added together to arrive at the total depreciation expense, which would be $83.306 million. The journal entry to record this is seen below (in millions)

12/31/01 dr. Depreciation Expense- Equipment- 83.306

cr. Accumulated Depreciation- Equipment 83.306

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

Below is what net income would have been had the line cost been properly expensed, rather than improperly capitalized.

WorldCom Inc. and Subsidiaries

Consolidated Income Statement

FYE 12/31/01

Operating Income	3,514,000,000
Deduct: Interest Expense	(1,533,000,000)
Miscellaneous `	412,000,000
Income before Income Taxes	2,393,000,000
Add: Depreciation from improper capitalization	83,306,819
Deduct: Line costs improperly capitalized	(3,055,000,000)
Income before tax (loss)	(578,693,181)
Income Tax Carried Over Next period	202,542,613
Minority Interest	35,000,000
Net Income (loss)	(341,150,568)

The difference in net income is absolutely material. WorldCom reported that they had $1.501 billion net income at the end of 2001, when in reality they lost income money of up to $3.41 million. This is a difference of over $1.842 billion which is drastically material. In my calculations, I assumed that the income tax of 35% will be carried over to next period, since it is impossible to tax a loss in income. I also assumed all other numbers besides depreciation from improper capitalization and line costs improperly capitalized were reported correctly.

Reflection

Case #6 turned out to be my favorite case of the semester. Seeing how WorldCom tried to manipulate their accounting records both fascinates and appalls me. Capitalizing expenses and hiding them in fixed assets and depreciating them over life seems clever at first, but their ten-year plan crumbled in less than a couple years. Thus, what stands out to me is that however tempting it may be to manipulate financial records, not only should it absolutely not be done, but also there is no "getting away" with doing wrong. In one of my other accounting classes, we learned that one of the WorldCom employees involved with this scheme graduated from Ole Miss, and Dr. D informed us in class that after the scandal, he came and spoke to the Patterson School of Accountancy in front of all his old professors and people whom he respected. The embarrassment and shame from that must have been a very heavy load to bear, and is a solid reminder to always abide by ethical and honest standards in the accounting world.

Case 7

Starbucks Corporation –

Understanding Financial Statements

March 6, 2019

Executive Summary:

Starbucks Corporation takes the spotlight as the topic of Case 7. Starbucks is best known as being a high-quality brewery that roasts and purchases whole bean coffee and sells its products, including espresso beverages, cold drinks, complementary food items, premium teas, and other Starbucks related apparel and utilities through other retail stores. The Case's learning objectives included becoming familiar with a set of consolidated financial statements and extracting information about the financial position of the company, as well as analyzing different footnotes and auditor opinions in order to discover more concerning the operations of the corporation. Learning the role estimation must serve in creating financial statements also takes part in the case. By the end of the case, one should become quite familiar with several different aspects in translating financial statements and drawing conclusions concerning the corporation's activities. This case greatly aided me in shaping my expectations for the analytical skills I will need when I work in public accounting. Instead of simply reading financial statements, I will need to be familiar with constructing financial data in order to effectively draw conclusions. For instance, in this case I had to construct a common sized balance sheet that shows each balance as a percentage of the total year-end assets. With this data, I should be able to scan the line items in order to see if any notable data stands out that could be indicative of needing further testing. After drawing conclusions, I should be able to send information to the partner in order for his own risk assessment and eventually determine the continued direction of the audit or advisory work.

a. Starbucks Corporation, referred to as Starbucks, is an international company that purchases and roasts high-quality coffees that they brew and then sell to customers to make money. Amongst their handcrafted coffee based products, they also sell tea beverages, fresh food, and license their goods to other chains such at grocery shops and convenience stores. The locations in which they operate include the United States, Canada, Europe, China, and more nationwide.

b. To externally report their financial information, Starbucks issues consolidated statements of earnings, consolidated statements of comprehensive income, consolidated balance sheets, consolidated statements of cash flows, and consolidated statements of equity. Consolidated financial statements are the grouping of the corporation's monetary information of the parent company and its subsidiaries together so that they can be presented as those of a single economic entity.

c. Public corporations usually prepare financial statements for external reporting purposes quarterly. They are also required to create their external financial statements available to the public.

d. Starbucks' management is responsible for establishing and maintaining financial reporting that are reliable and faithfully represent what actually happened during the quarter. They most likely have a chief financial officer that resides over the entire financial team. Management ensures that external reporting is in accordance of Generally Accepted Accounting Principles standards and regulation. Users of their financial statements would typically include investors, board members, upper level management such as CEO and CFO's, and stockholders in order to evaluate the position of the company. Evaluations include whether the company is providing a positive return on investments and to investigate if the company is in a healthy state. If it is in a healthy state, it can see where it might afford different investments and expenses, but if there is financial trouble, the company will be able to find what needs to be addressed.

e. Deloitte & Touche LLP, an independent registered public accounting firm, audits for Starbucks Corporation. After auditing their financial statements, Deloitte executes their responsibility to express an opinion on the information.

In 2013, Starbucks received two "opinion" letters from Deloitte's audit, both of which were unqualified opinions. Opinions are dated anywhere from up to two to four months subsequent from year end for the company so that the auditors can have time to gather sufficient and appropriate evidence to issue an opinion. The first opinion was based off an audit of the Company's financial reporting. An unqualified opinion in this aspect means Starbucks' consolidated financial statements were presented accurately in that they reflect the material operations of the business and that the financials were in compliance with GAAP standards. The second opinion was based off of the effectiveness of the Company's internal controls over financial reporting. An unqualified opinion for internal controls means that the Company's procedures are working in a manner that responsibly and reasonably prevents material misstatements for financial reporting. Since Starbucks is a public company, Deloitte is required under law to express an opinion on both the financial statements and internal controls of the corporation.

f. Below is a constructed common sized income statements and balance sheets for 2013 and 2012. These will be used to answer several questions that follow. The common sized balance sheet, shown on the next page, is created by dividing each figure based on that year's total assets. The common sized income statement, shown on the following page, is created by dividing each line item by total net revenues.

Figure 7-1: Common Sized Balance Sheet

Common Sized Balance Sheet	**29-Sep-13**	**30-Sep-12**
In millions		
Current assets:		
Cash and cash equivalents	22%	14%
Short-term investments	6%	10%
Accounts receivable, net	5%	6%
Inventories	10%	15%
Prepaid expenses and other current assets	2%	2%
Deferred income taxes, net	2%	3%
Total current assets	48%	51%
Long-term investments	1%	1%
Equity and cost investments	4%	6%
Property, plant and equipment, net	28%	32%
Deferred income taxes, net	8%	1%
Other assets	2%	2%
Other intangible assets	2%	2%
Goodwill	7%	5%
TOTAL ASSETS	100%	100%
Current liabilities:		
Accounts payable	4%	5%
Accrued litigation charge	24%	0%
Accrued liabilities	11%	14%
Insurance reserves	2%	2%
Deferred revenue	6%	6%
Total current liabilities	47%	27%
Long-term debt	11%	7%
Other long-term liabilities	3%	4%
Total liabilities	61%	38%
Shareholders' equity:		
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0%	0%
Additional paid-in capital	2%	0%
Retained earnings	36%	61%
Accumulated other comprehensive income	1%	0%
Total shareholders' equity	39%	62%

Noncontrolling interests	0%	0%
Total equity	39%	62%
TOTAL LIABILITIES AND EQUITY	100%	100%

Figure 7-2: Common Sized Income Statement

Common Sized Income Statement
12 months Ended

In Millions	29-Sep-13	30-Sep-12
Net revenues:		
Company-operated stores	79%	79%
Licensed stores	9%	9%
CPG, foodservice and other	12%	12%
Total net revenues	100%	100%
Cost of sales including occupancy costs	43%	44%
Store operating expenses	29%	29%
Other operating expenses	3%	3%
Depreciation and amortization expenses	4%	4%
General and administrative expenses	6%	6%
Litigation charge	19%	0%
Total operating expenses	104%	87%
Gain on sale of properties	0%	0%
Income from equity investees	2%	2%
Operating income	-2%	15%
Interest income and other, net	1%	1%
Interest expense	0%	0%
Earnings before income taxes	-2%	15%
Income taxes	-2%	5%
Net earnings including noncontrolling interest	0%	10%
Net earnings attributable to noncontrolling interest	0%	0%
Net earnings attributable to Starbucks	0%	10%
Earnings per share - basic	0%	0%
Earnings per share - diluted	0%	0%
Weighted average shares outstanding:		
Basic	5%	6%
Diluted	5%	6%
Cash dividends declared per share	0%	0%

g.

ii. Starbucks major assets are cash and cash equivalents, short-term investments, accounts receivable, inventories, property, plant, and equipment, and goodwill. Of the company's total assets, its short-term assets for 2013 are 48%, and its long term is 52%. This is appropriate for a large corporation like Starbucks, because it needs to be well-balanced and able to stay in tune with short term operations, while at the same time continuously invest in the future.

iii. Intangible assets are assets that physical in nature, however, they are still something own by the company and represents potential revenue. Their useful live is usually long term and greater than one year. Goodwill is an intangible asset that is associated with the purchase of one company by another. It includes the value of the company's brand name, customer base, and patents. Starbucks intangible assets include mainly its brand recognition and its trademark of the green circle with the longhaired woman in the middle.

iv. To find out how Starbucks is financed, it is appropriate to conduct the debt to equity ratio from its consolidated balance sheet. In 2013, its total debt was (in millions) $7,034.40, and its total equity was $4,482.30. Thus, its debt to equity ratio was 1.57, which reveals they are financed mainly by debt. The proportion of total financing from non-owners is found in the percentage of long term debt, which is 11%.

h.

i. Note 1 explains that Starbucks recognizes revenue on a cash basis. At the time the cashier receives the money from the customer and deposits it in the register, the payment is considered revenue on their books. This does not include indirect distribution of goods, such as gift cards. Only when Starbucks disseminates and ships its products to the customer revenue is recognized. Rarely is there an exception to recognizing the distributed gift cards as revenue, occurring when there is no doubt that the gift card will not be redeemed. But this should not be employed under regular circumstances and requires sound judgment by management.

ii. Starbuck's major expenses fall under their operating expenses, depreciation and amortization of fixed assets, general and administrative expenses, and litigation charges. Additionally, Starbucks incurs cost of sales, which is the amount that it takes to sell their products, and cost of labor, which is the cost the company pays their employees.

iii. The most significant cost amongst their expenses came from litigation charges, reaching over $2.7 billion.

iv. Starbucks reported separately their litigation charges in operating income because of its materiality in nature and to convey its significance honestly to its shareholders. Their legal disputes during this time was related more towards their operating activities, thus to portray and communicate its actions with faithful representation and accuracy.

v. In 2013, Starbucks' financial statements did not show a profit. This is due to its huge litigation charges, which was so large it exceeded their revenues by 4%. In order for a corporation to be profitable, its revenues must exceed its expenses, and Starbucks failed to do this in 2013. However, in 2012 they were profitable.

i.

i. Starbucks net earnings compared to their net cash provided do not match up from operating activities. Its net earnings were (in millions), $8.8 and net cash provided by operating activities only $2,908.3. The vast difference was largely due to the litigation charges it experienced, which Starbucks charged as a non-cash expense.

ii. Starbucks used $1,151.20 million on property, plant, and equipment during fiscal 2013.

iii. In 2013, Starbucks declared (in millions) $668.60, and paid $628.90.

j. Accounts that require estimates on Starbuck's balance sheet includes asset and goodwill impairments, stock-based compensation forfeiture rates, future asset retirement obligations, and inventory reserves. Additionally, Starbucks must estimate depreciation costs, revenue as a result from gift card costs, and warranty exepsnes. Estimate free accounts include cash, stock accounts such as common stock and additional paid in capital, and current liabilities.

Case 8

British Petroleum (BP) p.l.c -

Contingencies

April 3, 2019

Executive Summary:

Our eighth case's topic included BP (British Petroleum) p. l. c. and accounting for contingent liabilities. Operating in over eighty counties, BP is well known for being one of the world's largest oil and gas companies. The company mainly provides fuel for motorized tools and vehicles, but also energy for heat and light, retail services, and petrochemical solutions for household items. With handling such volatile products such as oil, gas, and energy substances, BP must adhere to several jurisdictions and laws, while considering the vast scope of climates in which the company and its subsidiaries operates.

In April of the year 2010, a massive explosion on the Deepwater Horizon sub-submersible rig resulted in eleven crew members' deaths and a two hundred million gallon oil spill in the Gulf of Mexico. As of 2011, over one hundred fifty thousand claims for damages and four hundred lawsuits had been filed from the disaster. The case dives into learning about the accounting implications of contingent liabilities due to unforeseen tragedy.

Prior to the case, I knew what a contingent liability was in theory, however, I had not thought about the reality of its severe implications from a disaster such as the BP oil spill. Thinking about working on an audit team to analyze and account for extreme contingency losses both excites and scares me. Upon reflecting on this case, I thought if I were a partner or head of an audit team assigned to BP, I would stress the importance in analyzing the different industries and people groups effected and filing lawsuits and claims from the spill. I would gather a team of experts, in BP's case, experts who knew about animal rescue, environment clean up, sea life rehabilitation, and more. Thus those experts would aid me in estimating costs to record as liabilities on BP's books. This case benefits my career path by providing insight on how to problem solve when disaster occurs. Careful examination and consideration is needed in accounting for damages and liabilities a company owes. Otherwise, the company is at risk for accounting for liabilities illegally or wrongfully. Accounting for contingent liabilities in equipment warranties is so much simpler than accounting for contingent liabilities in extreme cases such as the BP oil spill, however I learned the key in such as large task is heavily and cautiously gathering initial information in order to make the correct judgment call.

a. A contingent liability is a potential obligation for a company that might occur depending on uncertain future events. A company might record contingent liabilities based on different scenarios. If outcome of the future event is virtually certain, with at least a ninety percent probability of occurring, the company should report the contingent liability on its balance sheet as a liability. When likelihood of the event varies from fifty one to eighty nine percent probable, then the company should also record the contingent liability. However, if the outcome is only possible, between five and fifty percent, then the company should merely disclose the contingent liability, and if the outcome is remote, then the company should not record anything on its books.

Examples of contingent liabilities include product warranties, the inability for a company to obtain bank loans, legal disputes, and pending investigations. A contingent asset is a possible asset that arises from past events whose existence will be confirmed by an uncertain future occurrence not in control of the company. Examples of these include possible receipts of funds from donations, refunds from government tax disputes, and pending court cases with a probable favorable outcome. If the outcome of a contingent asset is virtually certain, it should be recognized as an asset on the balance sheet. If the contingent asset is probable, then it should be disclosed on the balance sheet. However, if the outcome is merely possible or remote, then the company should not disclose anything on its books.

b. From BP's perspective as the purchaser of the telescope joint, a product warranty would guarantee to repair any damages to the equipment within two years as well as correct any defects of the product. Additionally if the machinery were to collect wear and tear from heavy workload the warranty would include a promise from GE Oil and Gas to restore the telescope joint. In an extreme case of the telescope case breaking, the warranty should include a promise from GE to replace the equipment. From GE Oil and Gas' perspective as the manufacturer of the telescope joint, their side of the two year warranty is a contingent liability to fix, replace, or repair any damages in the telescope joint in case it breaks. The contingent liability should only be recognized on their books if the likelihood of the equipment needing repairs or replacing is probable or virtually certain. Additionally, a contingent liability should be able to be matched to its period of sale in order to be recognized

c. The judgment that management needs to actively make when accounting for contingent liabilities involves determining the likelihood that the event will occur. The likelihood of occurrence is the filter for if the contingent liability should be recorded in their books. If the likelihood of the event is virtually certain then the contingent liability ought be recorded on the balance sheet. If it is probable then it should also be recorded on the balance sheet, but if it is merely possible then it should only be disclosed as a footnote on the balance sheet. A contingent liability that is remote is neither recorded nor noted on the books. When accounting for accrued warranty costs in particular, management should determine the likelihood of a repair or replacement being needed for equipment within the two year warranty timeframe. If likelihood of the machinery needing replacement is remote, then management has no need to record the warranty in its books. However, if management determines repairs for the equipment are virtually certain or probable, they should record the warranty liability on its balance sheet.

The difference between a claim for damages from Horizon's oil spill and a telescope repair is that BP likely had the warranty claim for the telescope on their books as a contingent liability because repair from damages was probable. However, the likelihood of an event as unexpected and catastrophic as an oil spill was remote. BP had not accounted for the vast amount of damages due to an oil spill, so their financial statements took a large unexpected hit from the unforeseen liability.

d. As a result of the Deepwater Horizon oil spill, BP must consider its effects all across the globe throughout various people, organizations, and industries. Fisheries for salmon, herring, crab, shrimp, and other sea life had to be closed, which led to seafood industries having to suspend operations. Some species such as herring and salmon take years in recovery, with the possibility of not even making a full recovery. For many, fishing is an essential way of living and eating, but the consequences of the oil spill still effect people today. Tourism takes a huge hit with the oil spill, losing thousands of jobs and billions in sales. Vacationers do not feel as safe as they did before the spill due to seeing the area as contaminated.

Wildlife value took an enormous hit. To start, zoos pay as much as fifty thousand dollars to capture an otter, but the cost in losing dozens of these species is over one hundred million dollars. Zoos and animal rescuers cannot fund such a large amount of rehabilitation cost. BP has to contribute almost one hundred thousand dollars to rehabilitate the damaged otters. A quarter of a million seabirds were killed or wounded due to the spill, which costs around seventy million dollars to aid in helping them. BP must also consider the damages they have to pay for several other species such as whales and eagles.

In 1989 when the Exxon Valdez oil spill took place, the company spent over four billion in clean up costs. BP's clean up costs ranged even higher into the billions. Exxon owed an additional five billion to punitive damages and lawsuits, but in 1994 the Supreme Court ruled that Exxon only owed half a billion dollars. BP must also account for its employees and how they must compensate for their losses. The company should further consider different community service projects and environmental-friendly initiatives to serve the public.

Estimating all of these extreme continent liabilities above proves quiet challenging. They key in such a massive project lies in gathering a team of brilliant lawyers and experts in the various industries affected, such as environmental scientists and animal rehabilitation shelters. Experts can gather information to make reasonable and confident estimates of the massive costs to record as liabilities. Lawyers will be able to decipher which lawsuits are virtually certain, probable, and remote so that the proper liabilities will be recorded and recognized on the balance sheet. The recession caused many lawsuits to be invalid and not a result of the oil spill, so the team of experts and lawyers are needed in order to problem solve what costs are legitimate and should be accounted for in BP's financial statements. Due to the overwhelming amount of people, industries, and companies affected from the oil spill, BP should make a vast amount of space for contingent liabilities on its financial statements for many years. Lawsuits and recovery takes years to process and it will certainly take years for them to settle all of their obligations from the spill.

Case 9

Wendy’s Company – Equity Method Investments

April 10, 2019

Executive Summary:

This week's case was centered around analyzing Wendy's Fast Food Resteraunt Company and accounting for equity investments. Wendy's was opened by Dave Thomas in 1969, and has grown to be the third largest fast food chain worldwide, with operations spanning over twenty-six different countries. The case focuses information on Tim Hortons Inc, with whom Wendy's entered a 50-50 Canadian real estate joint venture. Tim Hortons owns and operates one hundred and five Wendys/Tim Hortons combo restaurants in Canada.

Throughout the case, I only had a small grasp on equity investments, but now I feel confident in obtaining a vast amount of knowledge about equity investments. I never considered all the advantages that both companies share in the creation of joint ventures, such as shared consumer markets and human capital. Clearly, sharing risk and reward between both companies is also a huge benefit. I have learned about equity investments and the accounting treatment for them in my intermediate class, but I greatly enjoyed having the opportunity to actually dive into actual financial statements to find the effects of a joint venture. I also enjoyed researching how a company accounts for an ownership purchase that exceeds their book value, because I had never considered that the premium amount turns into goodwill on the financial statements after different write-ups. Below are different questions that I have answered related to this case.

a. Forming a joint venture is a common business practice amongst companies for seeking to achieve a common goal or reach a specific consumer market. A joint venture involves two or more businesses joining under a temporary contractual obligation and agreement to work together for a period time. Benefits include shared resources, knowledge, human capital, and technology, while also diving risk and reward. Upon success, the companies share profit, but failure leaves with all parties involved sharing the same amount of losses.

b. The equity method of accounting represents an investor's holdings in stock between twenty percent and fifty percent. This amount of influence gives the investor power to exercise significant influence over the operating policies of an entity. Significant influence is exercised in several ways, including representation on the board of directors, participation in policy making processes, or having a voice in the changing of management. This method establishes a substantive economic relationship between investor and investee. In the financial statements, the investor originally records the investment at the cost of the shares acquired but substantially adjusts the amount each period for changes in the investee's net assets. Therefore, the investor's earnings increase the investment carrying amount, and losses decrease the amount. Companies using the equity method also report as revenue its share of the net income from the participating company, and dividends received are treated as a decrease in the investment carrying value.

c. Under the equity method, the investing company accounts for the excess amount in an investment compared to its book value by writing it up to its fair value. The objects that would be written up would be identifiable assets and liabilities that are clearly distinguishable. However, often times the written up amount still does not match the investments fair value. Thus, the difference would be goodwill, the premium one is willing to pay to acquire a valuable investment. To make sure the goodwill is not overvalued in the books, it should be tested for impairment each year.

d. After accounting for the joint venture with Tim Hortons Inc, the joint venture in Japan, and cost investments in entities such as Arby's and Jurlique, the carrying value for 2011 equity investments is $111,533, and the 2012's amount is 119,271. These are included in the investments amount on the consolidated balance sheet.

e. Note 8 discloses that the amount recorded for Wendy's investment in TimWen at the end of 2012 is $89,370, while the amount for Wendy's 50% share of equity is found by subtracting this investment by $54,088, which is the amount that exceeded the carrying value of the investment from the joint venture. Thus, Wendy's 50% share of equity by the end of 2012 is $35,282. The difference between these two accounts is accounted by the adjustments of the purchase price of ownership due to Wendy's agreeing to a joint venture with TimWen.

f.

i. Wendy's equity investment increased their equity in earnings before tax in 2012 and 2011 by $13,680 and $13,505, respectively. This appears in the "Other operating expense, net" section in their consolidated statement of operations.

ii. The journal entry to record Wendy's share of TimWen's 2012 earnings is as follows:

12/31/12	dr. Equity Investment	13,680	
	cr. Equity Income		13,680

iii. The amount of the amortization of the purchase price adjustments in 2012 is a $3,129. As a result, it decreases the equity in earnings for the period and is based on an average original aggregate life of twenty-one years. The journal entry is as follows:

12/31/12	dr. Loss on Investment	3,129	
	cr. Equity Investment		3,129

iv. Wendy's received $15,274 and $14,942 worth of dividends in 2012 and 2011, respectively. The journal entry to record the receipt of dividends in 2012 is as follows

12/31/12	dr. Cash:	15,274	
	cr. Equity Investments		15,274

g.

i. The information in Note 8 reconciles this amount by first taking the initial equity in earnings for the period and subtracting amortization from purchase price adjustments to arrive at $10,551. Then by subtracting that amount by equity losses from the period from their investment in the joint venture in Japan JV of $1,827, the books are left with the negative amount of $8,724 to account for net equity in earnings in joint ventures. A negative adjustment is made to arrive at net cash from operating activities because the earnings that were initially in net income are treated as outflows on the cash flows statement.

ii. The distributions received from joint venture of $15,274 is reconciled from distributions and dividends being received. A positive adjustment is made to arrive at net cash from operating activities because these distributions received are most likely dividends in the form of cash due to it being accounted for on the cash flows statement, not the income statement. It was not included in the income statement and needs to be in the statement of cash flows because dividends from joint venture partners, in Wendy's case TimWen, should not be accounted for as income.

Case 10

Johnson & Johnson – Retirement Obligations

April 19, 2019

Executive Summary:

Case 10 focuses on Johnson and Johnson and accounting for retirement benefits obligations through pension plans. Johnson and Johnson is a family owned company that was founded in New Jersey in 1887. The company broadens its work and is engaged in research and development, manufacturing, and health care field.

Prior to this case, I knew little to nothing about accounting for retirement obligations, but doing this case and taking an intermediate accounting test has made me confident in my knowledge of pension obligation accounting. One subject in particular that struck me while doing this case was the fact that companies have to estimate their expected return on plan assets, when the actual returns could completely differ. Pension plans can be very volatile in nature with the possibility of unexpected gains or losses throughout its lifespan. This case helped me consider how a company must account for these issues. I find it fascinating that FASB initiated the corridor approach with significant losses and how it aids the firm in not having to report a huge loss for a fiscal period. I also enjoyed how this case gave me the opportunity to determine if a plan is underfunded and overfunded. Finding this information on the balance sheet and seeing how Johnson and Johnson accounts for the plan further helped me in learning pension plan accounting.

a.

i. In a defined contribution plan, the employer agrees to contribute to a pension plan a certain sum each period based on a predetermined formula that considers factors such as age, length of employee service, employer's profits, and compensation level. This plan makes no promises concerning the final benefits paid out to an employee, for it only defines the employer's contribution.

A defined benefit plan outlines the benefits that employees will receive when they retire in the future. The benefits are usually a function of the employer's years of service and of the compensation level in the years approaching retirement, however, it can prove quite challenging to identify components that contribute to the function. The employer is responsible for the payment of the defined benefits for the continuity of the plan, therefore putting them at risk for the consequences of not paying the required amount. Johnson and Johnson has this type of pension plan.

ii. Retirement plan obligations are liabilities because the company is required to always contribute enough consideration to meet the cost of the benefits that the plan defines. The company owes the employee a certain amount in the future, thus they must continually contribute to the trust in order to meet their obligation to which the employee is entitled.

iii. In accounting for pension plan obligations, a number of assumptions are necessary due to the nature of plans being unknown. Different assumptions include mortality rates, employee turnover, interest and earnings rates, early retirement frequency, and future salaries.

iv. A flowchart explaining the cash flows between the employee and pension recipients is pictured below.

Figure 10-1: Retirement Plan Flowchart

b. Pension obligations' four main influencers are service costs, interest costs, actuarial gains and losses, and benefits paid to retirees. Service costs are expenses from what the company owes the employee for the work that they executed during the year. Actuaries compute service costs as the present value of new benefits earned by employees during the year. Interest costs are the expenses a company incurs for building a deferred compensation arrangement. Like any long-term funds, costs are accumulated and the time value of money must be considered. Interest costs should be considered on a period by period basis.

Sometimes the pension expense can change in a dramatic or unexpected way, resulting in gains and losses for the fund. These sudden swings usually come as a result of either sudden changes in the fair value of the plant asset, or changes in actuarial assumptions that affect the amount of the projected benefit obligation. FASB has developed a smoothing technique that aids in reducing the ramifications of dramatic losses. Benefits paid to retirees are the consideration that is being given to the retired employees for the period. If benefits are paid in the period, the obligation for the pension fund decreases and the plan assets account decreases due to the account from which the obligation is paid.

c. Actual Return on pension investments, company contributions to the plan and benefits paid to the retirees are three main types of activities in accounting for pension plans. The return on plan assets are an important measureable for it is returns on investments that are relatively straightforward to predict and can generally be relied on to earn a minimum return, such as investments in stocks, bonds, other securities, and real estate. These yield a decrease in pension expense, but an increase in plan assets. A direct way of finding actual return on plan assets is by subtracting the plan assets beginning balance from its ending balance for the year, and then from that number deducting the difference of contributions and benefits paid for the period. If actual return differs from expected return, then the plan must be adjusted, with the difference in amount being stored in Other Comprehensive Income- gains or losses.

Contributions to the pension plan are consideration given by the employer to fund the plan for the period. This is usually given in cash rather than a receivable or payable, and increases the plan assets amount. Benefits paid to retirees are the consideration paid out to the employees that no longer work for the company and represents the amount they deserve within the guidelines of the plan. Paying benefits thus decreases the company's pension benefit obligation, while decreasing the plan assets amount as well.

d. In accounting for pensions, there are two different types of return on assets, expected and actual. Expected returns are what the company predicts they will receive by the end of the year using a reasonable rate such as the settlement rate. The expected rate can also be used in regard with pensions in order to reduce market-induced volatility in the income statement Actual return on plan assets is the consideration actually incurred for the period. Often, these two numbers do not match; therefore the gain or loss should be recorded in other comprehensive income. If there is a substantial loss for the period that exceeds ten percent of either ending plan assets or projected benefit obligation, whichever is higher, then the company should amortize the difference over its life so that the company does not have to incur a big loss for the period.

e. omit

f.

i. For 2007, Johnson and Johnson reported a pension expense of 646 million dollars in their "net periodic benefit cost" account.

ii. The journal entry to record the service cost and the interest cost portion of the 2007 pension expense is as follows:

dr. Service Cost Expense	597 million	
dr. Interest Cost Expense	656 million	
cr. Projected Benefit Obligation		1,253 million

g.

i. The value of the retirement plan obligation at December 31, 2007 is $12,002 million. This value represents the future obligation Johnson and Johnson has for paying their retired employees consideration to which they have a right under the pension plan. In one aspect, this number is reliable because it includes expenses actually incurred such as interest costs and service costs. However, there are aspects of pension plans that can be unexpected such as return on plan assets and random unpredicted gains and losses.

ii. The pension related interest cost is $656 million. The average interest rate for 2007 is found by dividing $656 million by the previous years projected benefit obligation which was $11,660 million. Thus the interest rate was 5.62 percent. This rate does seem reasonable because the information provided in the footnote on page 61 of the case reports that in 2007 the discount rate was 6.5 percent for the United States plan and 5.5 percent for the international plan. This interest rate of 5.62 percent falls in between these two numbers.

iii. The amount of pension benefits paid for the year was $481 million. Johnson and Johnson paid these benefits in cash. Benefits paid decrease both the projected benefit obligation and the plan assets account.

h.

i. The value at the end of 2007 of the retirement plan assets was $10,469 million. This reflects reasonably expected returns the company estimates, such as changes in fair value, stocks, bonds, and interest revenue.

ii. Thee expected return on plan assets was $809 million, but the actual return on plan assets was $743 million. Thus, the company underestimated their return and the plant was underfunded for the year, incurring a loss. The loss is significant and will be amortized in excess of the corridor for its remaining service life. The expected return better reflects the economics of the company's pension expense because it reflects the need for more return on plan assets.

iii. For the retirement plan in 2007, Johnson and Johnson contributed $317 million, and employees contributed $62 million. In 2006, the company contributed $259 million, and the employees contributed $47 million, meaning both contributions increased from the year.

iv. Debt and Equity securities are investments in Johnson and Johnson's retirement plan. Of the United States retirement plan, 79 percent are equity securities and 21 percent are debt securities. In their report the company also disclosed that common stock directly held in plan assets was $462 million.

i. On the company's benefit obligation disclosures, the account titled "funded status – at the end of the year" reports that the retirement plan was underfunded by $1,533 million. The funded status is reported on the balance sheet under the "employee related obligations" account, and further indicates that notes five and thirteen discloses more information about the retirement plan including descriptions, types, and benefits.

Case 11

Balance Sheet vs. Income Statement

Model of Financial Reporting

April 26, 2019

Executive Summary:

Case 11 is based on an article published by the Columbia Business School titled "On the Balance Sheet-Based Model of Financial Reporting." The paper begins with an overview stating that its goal is to argue that the balance sheet orientation of accounting standard setting is flawed for various reasons. It explains that the balance sheet is at odds with advancing expenses to match with earned revenues, and that the concept of income is more useful to financial reporters than the asset-based balance sheet. The writers also introduce the idea that earnings, though the single most important outflow of the accounting system, is being destroyed by the expansion of the balance sheet approach. The last argument the paper rises is that the balance sheet approach has pushed an agenda of using more valuation estimated each year, which leads to dangerous and misleading feedback between predictions and economic reality. The overview ends with stating its two conclusions, firstly that accounting needs to make a sharp theoretical and practical distinction between operating and financing-type assets, and that operating activities needs a new emphasis on the principle of matching expenses to their revenues.

Currently, FASB and IASB are re-considering their conceptual frameworks, which is positive since uniformity and comparability are needed in the accounting profession. However, in the introduction the paper raises the argument that uniformity is not enough, and the governing bodies should further consider re-assessment of the balance sheet and give more attention to the income statement approach.

The article provides substantial history and background of the current balance sheet and income statement approaches for accounting. There is a long-standing debate between which approach should take precedence, and presently the balance state valuation, which focuses on measuring assets and liabilities, completely determines the income statement and more specifically earnings and matching expenses with revenues. These components of the income statement reflect more accurately the reality of present economic activity, yet the balance sheet is given more attention. The article emphasizes the fact that determination of earnings should be the goal of financial reporting.

In the first half of the 20th century, the income statement approach was dominant in the practice of accounting. When FASB was founded in 1973, their initial goal was to create a sound and workable foundation for financial reporting due to their predecessor's shortcomings. They constantly worked on this up to the end of the decade and reached the conclusion that the balance sheet is the only logical and sound basis of accounting and therefore should be the cornerstone of standard setting. This decision was influenced greatly on the fact that the income statement approach required vague concepts such as matching. Since then the balance sheet approach has continuously gained momentum, and the paper criticizes how boards such as FASB decided to concentrate on sorting through inconsistencies within the balance sheet and income statement rather than diving more into rethinking how the conceptual framework should reflect economic reality.

After providing the history of the balance sheet and income statement approaches, the article begins its critique of the balance sheet-based model of financial reporting centered around four main themes. The first of these is that the balance sheet approach is at odds with how most businesses operate, create value, and are managed. Companies are focused on advancing their expenses in order to earn revenue and earnings while assets are supplementary tools. The argument gives a great picture that if companies were asset focused they would be like greenhouses, storing and growing what they own. However, most companies are like furnaces, where they use or sacrifice assets in order to produce their prairie goal of revenues and earnings. Thus, being balance sheet focused does not make logical sense for companies. Additionally, investors make their decisions based off of income statement considerations. They evaluate businesses based off of revenues first, and then look at the balance sheet and cash flows statement. The income statement approach truly appears as the natural fit for evaluation of operations within companies.

The next argument of the article is that the concept of income provides a clearer and stronger foundation for financial reporting. This contradicts FASB, which has consistently believed conceptual framework should revolve around the balance sheet and specifically the asset. They paper argues that FASB tries to divorce the ideas of assets and revenues, as well as expenses and liabilities, when in reality they are deeply connected. They state the idea of an asset means there is an income stream attached to it. The concept of income is more fundamentally clear than the balance sheet, yet it does not take superiority in the conceptual framework of accounting. One can decipher a company's central and ongoing inflows and outflows more clearly than what a company owns.

The third critique that the paper argues is that balance sheet is likely a major contributor to the substantial temporal decline in forward-looking usefulness of earnings. Investors use earnings as their main measuring tool in evaluating prospective and existing investments. However, the balance sheet creates earnings that contradict what investors consider "good earnings." As a result, earnings volatility has doubled and persistence has almost halved. This is troubling because revenues, expenses, and cash flows have not changed nearly as dramatically. Evidence from research suggests that balance sheet accounting has resulted in marked deterioration in prospective information in earnings. If the trend continues into the next few decades, there is a threat that earnings will become meaningless.

The final argument the article rises is that there are significant problems with applying the balance sheet based model of accounting in practice. Market-to-market and fair value accounting creates feedback that might not reflect the reality of present economics or the business. When markets deviate from fundamental values, danger arises in reporting that is not accurate. Accounting ought recognize the difference between the economy and financial market and not merely compromise in reporting.

The next section of the article describes their idea of what a “better” conceptual framework looks like in their opinion. To make something better in their opinion is to equip the user with better understanding of financial reporting. Their first alternative idea is a clear theoretical and practical distinction between operating and financing activities. This distinction should be seen in all reporting aspects, particularly earnings and assets.

Another alternative method in which the writers of the article believe is a renewed emphasis on the matching principle and revenue recognition principle as cornerstones for operating activities. Accounting ought reflect the economic reality that most firms create value through the income statement, not the balance sheet. It would greatly aid the profession if there were even more detail in the revenue recognition principle and the matching principle.

To conclude, the article states they have not attempted to find a solution but rather spark a conversation. Given that FASB is currently reworking their conceptual framework, they plead that these issues must be considered, for the consequences will be felt for decades. Having the correct model of financial reporting benefits all people, organizations, and businesses in our society.

How did this article change your current way of thinking?

This article greatly challenged my way of thinking and invited me to look thoughtfully into the standards and values that are the foundation of my accounting studies thus far in my career. I have never considered the fact that FASB might be flawed in such a major way that significantly divides proper financial reporting and economic reality. The article "reset" my way of thinking and brought me back to the "building blocks" of accounting. A question that I am left asking myself is what is the goal of a company or firm? To me, the answer is clearly to generate revenue. A substantial inflow of cash speaks to a successful firm. While there are definitely benchmarks that companies desire to reach, at the end of the day operations center around making money. Thus it logically makes sense that the income statement should be the cornerstone of financial reporting, not the balance sheet.

An alarming topic that the article brought up is the claim that the current way of balance sheet accounting is "destroying" earnings. The balance sheet approach views assets as the store of value and earnings as "change in net assets," but this information is not anywhere near the earnings information for which investors primarily look. I never thought about how balance sheet accounting with its "change in net assets" is a pure market-to-market accounting, which means every asset account is updated at its fair market value. Thus, this leads to volatility and activity being unpredictable because of the nature of the market. This makes the balance sheet approach of earnings completely at odds with the income statement approach. This challenges me to question why the balance sheet approach is put before the income statement approach, when investors greatly rely on the latter.

Further, I did not realize that damage has already occurred with accounting for earnings. Studies have shown that over the last forty years, earnings of the largest one thousand U.S. firms have doubled in volatility and almost halved in persistence. This leads me to wonder how this has been addressed and why has there not been any action to reverse the trend. Additionally, this concern leads me to wonder how balance sheet accounting is affecting more accounts than just earnings. A primary goal of financial accounting is to report information accurately and honestly, but it seems as though there are components on the balance sheet that cause information not to match economic reality.

Both my favorite part and the biggest revelation for me of the article was concerning the critique of balance sheet financial reporting being problematic because it is at odds with how most businesses operate, create value, and are managed. The article began this topic by causing me to consider that revenues and expenses are central and ongoing while assets are merely temporary and a tool to achieve the main goal of revenues for the firm. Then, the writers created spectacular imagery, stating the balance sheet approach is like a greenhouse, because using it conveys a company's mere goal is to store and grow what they already own. This point in the article gave me the biggest opportunity to ponder to what extent the balance sheet should be used, because clearly companies do not operate by storing assets for long term use. Rather, as the article explains, companies operate as furnaces, constantly using assets in order to generate desired production and revenues. After finishing the article and with this imagery in mind, I am left trying to figure out and justify why FASB would use a balance sheet first approach when companies' main goals lie in their financial statements.

How will use this information in your future career?

Out of college and for the early part in my career, I will most likely not be working with the idea of challenging standards and rethinking the conceptual framework and would rather be learning the basics and establishing the groundwork for my career. However, I will most likely use this information the longer I stay in public accounting. This paper could launch the building blocks of a research project for my career. Whether I stay in public accounting or if I pursue teaching accounting for college student, I would greatly enjoy researching this topic. There is a philosophical side of me that enjoys challenging societal standards and structuring alternatives to see if they would work better than the existing rules, and the idea of replacing the balance sheet approach with the income statement approach would be a perfect fit for me.

Last semester in our thesis class, one of our speakers was an international KPMG recruiter who worked out of the New York office. He spoke on the opportunity he had to attend FASB conferences and seminars. Ever since he mentioned this, I have made attending conferences such as these one of my primary goals for my career. I desire to work hard so that I could be given an opportunity to attend meetings such as these that discuss and debate GAAP and other FASB standards. Moving forward, I believe the most important idea to keep in mind is that as an accountant, I must strive for continuous learning and constant rethinking of how standards can improve to better equip the workers of the profession. I would be robbing myself if I became complacent in my career, and instead I should constantly find opportunities to enable accounting with its main goal, to report financial information that is useful and honest.

Case 12

Google Inc. – Earnings Announcements and Information Environment

May 3, 2019

Executive Summary:

Google Inc. takes the topic of case twelve, focusing on earnings announcements, press releases, and the information environment. Incorporated in 1998, Google operates global internet search engines and provides various activities such as news, images, and shopping through its network. The case focuses much on how quarterly press releases affect the market and investors' decisions, when the press releases might not include GAAP information.

This case caused me to consider many ideas that I have not thought of prior to completing this work. I am left wondering where the line is between strategic planning and dishonest manipulation. Google constructed their own financial statements using non-GAAP measures, and pushed those in the public on order to boost their stock price and market image. While this is positive for Google, I ponder if this is fair for other companies. One of the main benefits of GAAP standards is that it provides universal policies that regulate financial reporting for all public companies in order to prevent giving a particular company any sort of advantage Using these measures decreases reliability and comparability of financial statements, two values that FASB has worked tirelessly on improving the last few years. The case leaves with the main concept that there is a key need for better organization and presentation of performance information. I learned that both non-GAAP and GAAP measures are highly valued together for analysts and should be used, but there should be clear standards and frameworks that diminish any concern for manipulation.

h.

ii. In addition to preparing financial statements in accordance with GAAP for external purposes, Google prepares financial statements using non-GAAP measures for the purpose of providing useful information to internal operations and decision makers of the company. Thus, accounts such as GAAP net income and non-GAAP net income will be different amounts. The case provides a table that reconciles GAAP measures to the non-GAAP measures. For 2012 and 2013, net income is higher in non-GAAP reporting compared to required GAAP standards. The difference in the net income amount is due to several adjustments, including eliminating stock-based compensation expense, eliminating restructuring related charges, and eliminating income tax effects related to the stock based compensation expense. Additionally, Google removed income tax effects related to restructuring related charges and removed net losses from discontinued operations in their non-GAAP financial reporting

I agree to an extent with Google's adjustments in their non-GAAP financial reporting for net income because they are using this measure for the purpose of internal evaluation and decision-making. By eliminating costs that are infrequent and out of the ordinary, the company can evaluate their operations based on their own business structure and goals. However, I do not believe they should have eliminated stock based compensation expense, and rather should have included it in their non-GAAP calculations, because assessing various stock-based compensation expenses will consistently be an ordinary expense for operations. Google explained their stock-based compensation expenses were estimated from grants prior to the end of 2013. Although this might appear as an infrequent charge, there will regularly be various charges and different situations related to stock based compensation expenses, therefore I believe it should be included in non-GAAP financial calculations.

i.

i. At the end of 2013, Google reported $707 thousand dollars per share for its fiscal earnings. Throughout the next year, its stock price continually grew, and by the end of the year the number had increased to $1,120 thousand dollars per share, while still continually growing onto the next year.

ii. For the entire year, Google's shares were higher than the broader set of firms on the NASDAQ exchange. Toward the end of the year in particular, the Google's stock price spiked to over 10 percent greater than the NASDAQ index, and towards the start of the following year its stock price was rising almost double the percentage compared to the NASDAQ index.

iii. The stock market chart indicates that the market perceived the earnings in Google's press release as significantly good news. Due to the company's press release, Google's stock price was very successful because it increased the entire year and consistently rose above the NASDAQ average. Google's stock price was rising almost double the percentage around this time compared to the NASDAQ average.

j.

i. Analysts had predicted that Google would have earnings of $12.20 a share, but Google did not meet this expectation and reported earnings of $12.01 a share. However, according the article investors "shrugged off" the fact that earnings were slightly lower than expected, because of the tremendous revenue growth Google produced within the year. The company reported a seventeen percent increase in revenue for the fourth quarter, as well as a seventeen percent increase in net income. These results are consistent with the positive stock market reactions following the press release due to Google's successful momentum.

ii. Other factors that might contribute to the positive reactions that the market for advertising was drastically increasing around this time. Google paid special attention to investing in advertising for the year and greatly paid off. Google Play on android smartphones also played a huge roll for positive reactions, because around this time consumers were both interested and buying the product. Additionally, Google has continued to heavily invest in computers and data centers that increases the speed of delivery for search results and YouTube videos, a quality that consumers not only greatly value, but also on which they depend. Factors that might lead to concerns for Google's performance is that the average amount that Google receives per click has declined eleven percent from last year and is projected to continue to decline. As the use of smartphones increase, advertisers will pay less for advertisements on mobile phones than compared to desktop computers.

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