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An Exploration of Financial Accounting Methodologies and Ethical Decision Making Through Independent Case Studies

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AN EXPLORATION OF FINANCIAL ACCOUNTING METHODOLOGIES AND ETHICAL DECISION MAKING THROUGH INDEPENDENT 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

COURTNEY PAIGE CRAVEN: An Exploration of Financial Accounting Methodologies and Ethical Decision Making Through Independent Case Studies
(Under the Direction of Victoria Dickinson)

The following thesis consists of 12 individual case studies that explore various financial accounting methodologies and common ethical challenges. When applicable, each case agrees with the Generally Accepted Accounting Principles as created by the Financial Accounting Standards Board. No topic is explored twice as each case presents different issues than the others. Each case begins with an executive summary that states broadly its purpose and what the key takeaways were. Then, the cases explore solutions to common issues within the accounting profession. These cases were completed during the 2018-2019 academic year during honors accounting independent study class (ACCY 420) under the direction of Victoria Dickinson and fulfills requirements of the Patterson School of Accountancy and the Sally McDonnell Barksdale Honors College.

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Case #1 - Data Analytics

Purpose:

The purpose of this case was to have students be familiarized with a particular data analytics tool and its relation to the accounting profession. I was assigned IBM's Watson. I first had to conduct research on the history and purpose of Watson to understand fully what it is today. Then, I learned how it is used to make decisions in business. Next, I came up with different scenarios specific to tax accounting and auditing work where Watson would play a key role in advancing the future of the business. These ideas were mostly original as Watson has only just begun aiding accounting firms in their services. Additionally, I wrote a short memo to my future public accounting partner explaining why we should invest in Watson to help grow our services. In this memo, I am persuading my future partner to invest in Watson since it would be an extremely valuable tool with its state of the art processing abilities.

Takeaway:

After conducting this case study, I am now more aware of how data analytics tools, specifically IBM Watson, can be used to advance the accounting field. Before starting work on this case, I had no prior knowledge of any kind of data analytics tool, so I especially did not know how one of these tools could be used in the field of accounting. I am now infinitely more knowledgeable in how to take advantage of the technological resources available to make my future job more enriched. I feel well versed in the significance of data analytics and its relation to the accounting field as a whole.

a. **Identify the purpose of IBM Watson and describe how it is used to make business decisions.**

IBM Watson is a powerful supercomputer that is creating a huge name for itself in the business world. However, it was initially created to be the first machine to pass the Turing test, which measures machine intelligence by having conversations so human-like that a person would think they were talking to one of their own. However, after preliminary research, the team working on the project decided to take it in another direction. They decided to design a machine that would compete, and win, on the TV game show 'Jeopardy'. To achieve this goal, the design team equipped the machine with a software called DeepQA. Simply, DeepQA takes a question, dissects it and then comes up with all the possible answers to the question. This software allowed Watson to have over 200 million pages of information queried, locally stored and ready to resuscitate instantly (Best). The work with Watson proved successful as Watson faced the two winningest players on Jeopardy and won. (Markoff).

After the Jeopardy win, the researchers in the newly created IBM Watson business unit went to work on shifting Watson's purpose from competing on game shows to making business decisions. The team's first target industry was healthcare, but they knew Watson would aid any industry that relied on the analysis of tons of structured and unstructured data. They wanted Watson to be able to scan through and analyze data at rates exponentially quicker than the humans currently in the business. The CEO of the Watson business unit, Manoj Saxena, commented on the tremendous work done on Watson after Jeopardy and said, "The system today compared to the Jeopardy system is approximately 240 percent faster and it is one-sixteenth the size. The system that was the size of a master bedroom will now run in a system the size of the vegetable drawer in your double-drawer refrigerator." (Best).

As for actually making business decisions, Watson can analyze data in any state that is fed to into it as well as information from the internet. This includes anything from documents to voice recordings. One example of how Watson is currently used in business is through making banking decisions. Watson can determine the risk that clients will not repay loans as well as detecting possible fraud in customers' accounts. Additionally, Watson can be used as a customer service tool. It can have instantaneous one-on-one conversations with customers similar to an extreme version of Apple's Siri or Amazon's Alexa (Best). Watson can take information about a company's product or service from its internally inputted data and use it to make informed recommendations to customers. This can make relationships with customers more personal, trustworthy, and immediate.

b. How Watson can be used in Auditing

Although not currently widespread, Watson would be a great help to those in the accounting field. Watson would be quite useful in the beginning stages of auditing when auditors sort through and analyze the information their clients give to them. This data usually includes financial statements, bank statements, and depreciation schedules along with other types of structured and unstructured data. Without Watson, auditors have to pull random samples of data to check for errors or fraud since filing through every bit of data for each entity is impossible. However, Watson can do this tedious part of the audit. Auditors can feed Watson all of the data they receive, and it can search through and analyze every single piece of data about the entity to ensure complete accuracy of the audit. This will make audits much more efficient since it will cut out huge amounts of work time. Watson can also ensure that no piece of data goes unnoticed which leaves virtually no room for error or fraud.

Another situation in auditing where Watson would be helpful is in making recommendations to a client on how to improve their company's functions. This is typically what auditors spend the most of their time on, but Watson can aid in speeding up this process. Watson can analyze all the data given to it in the form of financial statements, meeting minutes, and sales data along with others to make recommendations on how to improve functions. For example, Watson could take the income statement of a company for the previous five years, break down any changes, and give suggestions on how to improve any of the numbers on that statement. If desired, Watson can also compare those numbers to those of other competing companies to see how the entity is doing in comparison to the market. These are all things that humans are capable of doing, but Watson can do the analyses quicker and often times more accurate. This does not mean that Watson will completely replace people though. The auditors will still need to perform their own analyses since a human's perspective is still better overall than Watson's, but Watson can be used to reinforce their recommendations or even come up with other possible solutions the auditor may not have considered.

A third scenario where Watson would be helpful in auditing is in making predictions for the company being audited. Although Watson's predictive abilities are still being fine-tuned, in the next few years Watson will have incredible prediction abilities (Slowey). Watson can make predictions on how much revenue the company will bring in based on the past records as well as predicted economic conditions for the upcoming year. As a predictive tool, Watson can help a company have more effective budgeting and more efficient use of its resources.

c. How Watson Can Be Used in Tax Planning

In tax accounting, laws are ever changing and extremely specific, so it is crucial that a tax accountant be well-versed in all of the legality surrounding taxes. When a tax accountant is looking to make sure all of his or her work is within the limits of the law, Watson would be a great helper. Watson can take all of the taxation laws and make sure that a tax accountant's work is within them while also being able to point out any areas that may be in violation. This does not mean tax accountants should stop being informed about tax law, but Watson would be a nice supplemental check so that they know they are making the right decisions.

Another way Watson would be beneficial to tax accountants is by providing insight on the best new places to expand a business as it relates to taxation. If a company is looking to expand but wants to go overseas to where they will be taxed the least amount, Watson can help them decide what the best option is. Watson can recommend the most profitable place for a company to expand based on their criteria of needs and how they will be taxed. For example, the corporate tax rate in the United States averages about 38.9% whereas Ireland averages about 12% (Jahnsen). Watson can run analyses on the pros and cons of expanding overseas to recommend the best area for each specific company. This would help every client to do more effective business and maximize income.

On a more common note, Watson could simply suggest to clients potential ways that they can receive the most tax relief. This is the main job of tax accountants, but Watson can do this by digesting all of the client's income data, structured and unstructured, and finding ways, within the limits of the law, to get them the highest return possible while also generating the most revenue for the accounting firm. Watson will take into consideration all possible tax deductions, find all possible business tax credits, and make sure the client is in the proper tax bracket. This will in no way replace tax accountants but will only make their jobs more efficient by reducing time spent analyzing data and allowing them to spend more time making effective decisions for clients.

d. Why You Should Invest in the Acquisition of Watson For Your Team

To: Future Partners

From: Courtney Craven

Date: September 29, 2018

Subject: Acquisition of IBM Watson

As a team, it would be a smart business decision to invest in IBM's Watson. Watson is a super computer that is like a brilliant-minded human rather than just a search engine. Watson is able to read, analyze, learn and make contextual decisions just like humans do. We can simply feed Watson the data we want it to process from our internal sources and it will combine that with information from the internet to answer any question we need it to.

Watson can make our team more efficient and effective. On the auditing side, we can feed Watson all of the information we receive from clients and it can search the data for errors, outlying numbers, or potential fraud. These are processes that would normally take a large portion of our time and it is impossible to look at every line of every document. However, Watson can do it all and in a fraction of the time any human could. This could eventually cut out the need for abundances of lower level accountants and allow each auditor to only do the intuitive parts of the audit rather than the tedious ones. It would also allow the firm to place fewer auditors with each case and have them spread out across more clients, which would generate more revenue. Watson can also aid in predicting future economic conditions and produce more accuracy in budgeting.

As far as the benefits for taxation, Watson would be able to make recommendations to clients on how to get the most tax relief based on their current position but would do so while still generating the most revenue for the firm. Furthering that, it would also ensure that every client's taxes are completely within the limits of the law. It would keep up with any change in tax law and serve as a nice check for the accountants. Watson would also be able to make recommendations on where companies should relocate to get the most tax relief with the least adverse consequences. This would allow accountants to be well versed with the law in the United States and less worried with the specifics of international tax laws.

Overall, Watson would allow fewer lower level accounting positions, but would make almost all accounting jobs insightful, decision-based jobs. Watson would not decrease the need for accountants generally because they would be dispersed over many different clients rather than having large teams dealing with each client. Watson would take this firm to the next level competitively while having almost no adverse effects, so we should strongly consider investing in this business changing tool.

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Case #2 - Rocky Mountain Chocolate Factory

Purpose

The purpose of this case was to show how a corporation goes through the accounting cycle. To effectively complete this case, one had to be competent in the double entry accounting system, be well-versed on how to accurately form financial statements, and be able to interpret the data after it was constructed. Another purpose of this case was to be able to appreciate the linkages between each step of the accounting cycle and see the effects each one has on the others. Lastly, an important takeaway from this case was to see the difference in accrual versus cash basis accounting and understand why the accrual basis is in compliance with GAAP.

Takeaway

This case was a real-world application of the accounting cycle, which is something I have never done before. I learned about what accounts are frequently used in the real world along with how companies actually account for their resources. Prior to this, I had only worked with make believe examples, but this case gave me a new perspective on what actually goes into preparing real financial statements. Another peripheral skill I developed through this case was the mastery of Excel. I had background knowledge of Excel, but this case allowed me to understand real applications of the software. This case gave me a small taste of what auditing will be like in my first accounting job.

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 major assets? Which accounts constitute major liabilities?

Prior to examining the company's balance sheet, I expect to see Cash, Accounts Receivable, Inventory, Accounts payable, Dividends payable, and Common and Preferred Stock accounts to be on the balance sheet. I think Cash and Inventory constitute major assets and Wages payable and Long-Term notes payable accounts constitute major liabilities.

b. Prepare journal entries, as needed, for each of the following fiscal 2010 "transactions" and post to the spreadsheet. All figures are in thousands of dollars. See figure 2-1.

1. The company purchased $7,500,000 of raw material inventory on account. "On account" means that their suppliers have not yet been paid. That is, Rocky Mountain Chocolate has an additional "Account Payable" for the inventory purchase.
2. During the year, the company incurred $6,000,000 of factory wages. When wages relate to the production of a company's inventory, the wage costs are added to the inventory account. For now, assume that the wages have not yet been paid.
3. The company sold inventory that cost $14,000,000 for a total of $22,000,000. Of that, $17,000,000 was received in cash and $5,000,000 was on account (that is, added to accounts receivable).
4. The company paid $8,200,000 to suppliers for inventory it had previously purchased on account. That is, it paid $8,200,000 of accounts payable.
5. The company collected $4,100,000 of accounts receivable
6. The company incurred sales and marketing expenses of $1,505,431, general and administrative expenses of $2,044,569, and retail operating expenses of $1,750,000. They paid $2,000,000 in cash and $3,300,000 was added to other accrued expenses.
7. The company paid $6,423,789 to employees for wages that had been previously accrued.
8. Rocky Mountain Chocolate Factory received $125,000 in cash from new franchisees. The company must provide services to the franchisees over the next five years. As such, the fees are considered deferred income.

9. The company paid $498,832 for new property and equipment.
10. During the year, the company declared $2,407,167 of dividends on its common shares. They paid $2,403,458 during the fiscal year. The difference, $3,709, will be paid in the following fiscal year.
11. Many other transactions were recorded during the year. They are summarized in the spreadsheet. Do not attempt to interpret individual entries as many involve offsetting debits and credits and the resulting values are net figures.

c. Prepare an unadjusted trial balance from the spreadsheet.

See figure 2-1.

d. Based on the transactions you recorded in parts *b* and *c*, list at least three adjustments or reclassifications that might need to be made prior to preparing the final financial statements.

I predict that the inventory, wages, and depreciation expense will have to be adjusted after the end of the period.

e. Prepare journal entries for the following adjustments then post the journal entries to the spreadsheet and complete the pre-closing trial balance column.

See table 2-2.

1. Rocky Mountain Chocolate Factory employees took a physical count of inventory on February 28, 2010. The cost of inventory in the company's possession on that date was $3,281,447.
2. Depreciation and amortization expense on property and equipment was $698,580 for the fiscal year.
3. At year end, the company determined that $646,156 of wages were earned but remained unpaid. Of that total, $639,200 relates to general and administrative expenses, and $6,956 relates to retail operating expenses.
4. In February 2010, a consulting firm hired by Rocky Mountain Chocolate Factory issued a report stating that the "Rocky Mountain Chocolate Factory" brand name is worth $500,000.

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

f. Construct an income statement for the year ended February 28, 2010.

See table 2-3.

g. Close all the temporary accounts on the income statement to Retained earnings. Complete the post- closing (ending) balance column. Verify that the amounts for the balance sheet accounts in the post- closing balance column match the amounts in the actual February 28, 2010 financial statement column.

See table 2-4.

h. Prepare the February 28, 2010, balance sheet.

See table 2-5.

i. For each transaction, indicate whether the transaction would appear in the “operating,” “investing,” or “financing” section of the statement of cash flows.

See table 2-6.

Figure 2-1

Account Name	Beginning Balance (2/28/09)	Purchase inventory	Incur facory wages	Sell inventory for cash and on account	Pay for inventory	Collect receivables	Incur SG&A (cash and payable)	Pay wages	Receive franchise fee	Purchase PPE	Dividends declared and paid	All other transactions	Unadjusted trial balance
Cash and Cash equivalents	$ 1,253,947			$ 17,000,000	$ (8,200,000)	$ 4,100,000	$ (2,000,000)	$ (6,423,789)	$ 125,000	$ (498,832)	$ (2,403,458)	$ 790,224	$ 3,743,092
Accounts receivable	4,229,733			5,000,000		(4,100,000)						(702,207)	4,427,526
Notes receivable, current	0											91,059	91,059
Inventories	4,064,611	7,500,000	6,000,000	(14,000,000)								(66,328)	3,498,283
Deferred income taxes	369,197											92,052	461,249
Other, current	224,378											(4,215)	220,163
Property and Equipment, net	5,253,598									498,832		132,859	5,885,289
Notes receivable, less current portion	124,452											139,198	263,650
Goodwill, net	1,046,944												1,046,944
Intangible assets, net	183,135											(73,110)	110,025
Other, noncurrent	91,057											(3,007)	88,050
Accounts payable	1,074,643	7,500,000			(8,200,000)							503,189	877,832
wages	423,789		6,000,000					(6,423,789)					0
Other accrued expenses	531,941						3,300,000					(2,885,413)	946,528
Dividend payable	598,986										3,709	(1)	602,694
Deferred income	142,000								125,000			(46,062)	220,938
Deferred income taxes	827,700											66,729	894,429
Common stock	179,696											1,112	180,808
Additional paid-in capital	7,311,280											315,322	7,626,602
Retained earnings	5,751,017										(2,407,167)		3,343,850
Sales	0			22,000,000								944,017	22,944,017
Franchise and royalty fees	0											5,492,531	5,492,531
Cost of sales	0			14,000,000								693,786	14,693,786
Franchise costs	0											1,499,477	1,499,477
Sales and marketing	0						1,505,431						1,505,431
General and administrative	0						2,044,569					(261,622)	1,782,947
Retail operating	0						1,750,000						1,750,000
Depreciation and amortization	0												0
Interest income	0											(27,210)	(27,210)
Income Tax Expense	0											2,090,468	2,090,468

Figure 2-2

Account Name	Unadjusted trial balance	Adjust for inventory count	Record depreciation	Wage accrual	Consultant's report	Pre-closing trial balance	Closing entry	Post-closing trial balance	Actual February 28, 2010 figures
Cash and Cash equivalents	$ 3,743,092					$ 3,743,092		$ 3,743,092	$ 3,743,092
Accounts receivable	4,427,526					4,427,526		4,427,526	4,427,526
Notes receivable, current	91,059					91,059		91,059	91,059
Inventories	3,498,283	(216,836)				3,281,447		3,281,447	3,281,447
Deferred income taxes	461,249					461,249		461,249	461,249
Other, current	220,163					220,163		220,163	220,163
Property and Equipment, net	5,885,289		(698,580)			5,186,709		5,186,709	5,186,709
Notes receivable, less current portion	263,650					263,650		263,650	263,650
Goodwill, net	1,046,944					1,046,944		1,046,944	1,046,944
Intangible assets, net	110,025					110,025		110,025	110,025
Other, noncurrent	88,050					88,050		88,050	88,050
Accounts payable	877,832					877,832		877,832	877,832
wages	0			646,156		646,156		646,156	646,156
Other accrued expenses	946,528					946,528		946,528	946,528
Dividend payable	602,694					602,694		602,694	602,694
Deferred income	220,938					220,938		220,938	220,938
Deferred income taxes	894,429					894,429		894,429	894,429
Common stock	180,808					180,808		180,808	180,808
Additional paid-in capital	7,626,602					7,626,602		7,626,602	7,626,602
Retained earnings	3,343,850					3,343,850	3,580,077	6,923,927	6,923,927
Sales	22,944,017					22,944,017	(22,944,017)	0	22,944,017
Franchise and royalty fees	5,492,531					5,492,531	(5,492,531)	0	5,492,531
Cost of sales	14,693,786	216,836				14,910,622	(14,910,622)	0	14,910,622
Franchise costs	1,499,477					1,499,477	(1,499,477)	0	1,499,477
Sales and marketing	1,505,431					1,505,431	(1,505,431)	0	1,505,431
General and administrative	1,782,947			639,200		2,422,147	(2,422,147)	0	2,422,147
Retail operating	1,750,000			6,956		1,756,956	(1,756,956)	0	1,756,956
Depreciation and amortization	0		698,580			698,580	(698,580)	0	698,580
Interest income	(27,210)					(27,210)	27,210	0	(27,210)
Income Tax Expense	2,090,468					2,090,468	(2,090,468)	0	2,090,468

Figure 2-3

Rocky Mountain Chocolate Factory Income Statement For Year Ended 2/28/10		
Account	**Balance**	
Revenues:		
Sales	$	22,944,017
Franchise and Royalty Fees		5,492,531
Total Revenues	$	28,436,548
Operating Expenses:		
Cost of sales	$	(14,910,622)
Franchise costs		(1,499,477)
Sales and marketing		(1,505,431)
General and administrative		(2,422,147)
Retail operating		(1,756,956)
Depreciation and amortizatioı		(698,580)
Total Operating Expenses	$	(22,793,213)
Operating Income		5,643,335
Interest income		27,210
Income before income taxes	$	5,670,545
Income Tax Expense		(2,090,468)
Net Income	$	3,580,077.00
Basic Earnings Per Common Share	$	0.60
Diluted Earnings Per Common Share	$	0.58

Figure 2-4

Account Name	Pre-closing trial balance	Closing entry	Post-closing trial balance	Actual February 28, 2010 figures
Cash and Cash equivalents	$ 3,743,092		$ 3,743,092	$ 3,743,092
Accounts receivable	4,427,526		4,427,526	4,427,526
Notes receivable, current	91,059		91,059	91,059
Inventories	3,281,447		3,281,447	3,281,447
Deferred income taxes	461,249		461,249	461,249
Other, current	220,163		220,163	220,163
Property and Equipment, net	5,186,709		5,186,709	5,186,709
Notes receivable, less current portion	263,650		263,650	263,650
Goodwill, net	1,046,944		1,046,944	1,046,944
Intangible assets, net	110,025		110,025	110,025
Other, noncurrent	88,050		88,050	88,050
Accounts payable	877,832		877,832	877,832
wages	646,156		646,156	646,156
Other accrued expenses	946,528		946,528	946,528
Dividend payable	602,694		602,694	602,694
Deferred income	220,938		220,938	220,938
Deferred income taxes	894,429		894,429	894,429
Common stock	180,808		180,808	180,808
Additional paid-in capital	7,626,602		7,626,602	7,626,602
Retained earnings	3,343,850	3,580,077	6,923,927	6,923,927
Sales	22,944,017	(22,944,017)	0	22,944,017
Franchise and royalty fees	5,492,531	(5,492,531)	0	5,492,531
Cost of sales	14,910,622	(14,910,622)	0	14,910,622
Franchise costs	1,499,477	(1,499,477)	0	1,499,477
Sales and marketing	1,505,431	(1,505,431)	0	1,505,431
General and administrative	2,422,147	(2,422,147)	0	2,422,147
Retail operating	1,756,956	(1,756,956)	0	1,756,956
Depreciation and amortization	698,580	(698,580)	0	698,580
Interest income	(27,210)	27,210	0	(27,210)
Income Tax Expense	2,090,468	(2,090,468)	0	2,090,468

Figure 2-5

Rocky Mountain Chocolate Factory Balance Sheet For Year Ended 2/28/10		
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, current	220,163	
Total Current Assets		$ 12,224,536
Property and Equipment, net		$ 5,186,709
Other Assets		
Notes receivable, less current portion	$ 263,650	
Goodwill, net	1,046,944	
Intangible Assets, net	110,025	
Other, noncurrent	88,050	
Total Other Assets		$ 1,508,669
Total Assets		**$ 18,919,914**
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$ 877,832	
Accrued salaries and wages	646,156	
Other accrued expenses	946,528	
Dividend payable	602,694	
Deferred income	220,938	
Total Current Liabilities		$ 3,294,148
Deferred income taxes		$ 894,429
Stockholders' Equity		
Common stock	180,808	
Additional paid-in capital	7,626,602	
Retained earnings	6,923,927	
Total Stockholders' Equity		$ 14,731,337
Total Liabilities and Stockholders' Equity		**$ 18,919,914**

Figure 2-6

Transaction	Transaction Type (Operating, Financing, or Investing)
Purchase inventory	Operating
Incur facory wages	Operating
Sell inventory for cash and on account	Operating
Pay for inventory	Operating
Collect receivables	Operating
Incur SG&A (cash and payable)	Operating
Pay wages	Operating
Receive franchise fee	Investing
Purchase PPE	Investing
Dividends declared and paid	Financing
Adjust for inventory count	Operating
Record depreciation	Operating
Wage accrual	Operating

Case #3 - Future Employment Scenarios

Purpose:

The purpose of this case was to enable students to deeply think about their future careers in accounting. To do this, we were presented with three common scenarios from Ole Miss Accountancy students and we were to choose whether we thought the students' reasoning was justified or unjustified. We all chose a side, agree or disagree, for each scenario then discussed our reasoning behind our decisions. The scenarios all involved students' future plans after finishing their undergraduate degree at Ole Miss. These scenarios mostly pertained to the ethics around accepting an internship with an accounting firm when the length of time the student would be staying is unsure. There was no right or wrong answer to any scenario, only matters of opinions.

Takeaway:

After participating in this group discussion, my own views on my future are much more concrete. Prior to this case, I was quite unsure of how I wanted to spend my time after my undergraduate program, but I am now much more familiar with what my path may look like. I understand the importance of thoroughly thinking through what city I would like to work in, what graduate path I would like to take, and the length of time I would like to do accounting work. Other than my own goals, I am also now aware of the logic behind other students' goals when they choose paths different from mine. I was previously unsure why any accountancy student would want to pursue a law degree after getting their undergraduate accounting degree, but now I am much more receptive of that idea. I also understand the importance of staying at a firm for a few years after being hired to ensure they get a return on hiring new interns. This was an eye-opening case and I now understand other students' views as well as my own on a deeper level.

Scenario 1:

The first scenario presented to the class involved a student wanting to go to law school following the receipt of their undergraduate degree instead of following the typical path of staying fifth graduate year to become a CPA. As for my position on this argument, I am firmly against the idea of law school unless that student is one hundred percent certain that they will stick with it and do not plan to accept an accounting internship. Going to law school would narrow that student's horizons and would limit them to only working in a law firm. In addition, one graduate year for accounting versus three years of law school is an extremely large difference in cost. It is true that most lawyers get out of school making more money than CPAs, but the debt of law school will quickly even out the pay difference. Additionally, I believe it is unethical for students to get their undergraduate degree in accountancy, secure an internship at an accounting firm, but then opt for law school and never actually work for an accounting firm. These accounting firms spend too much time and money on recruiting and training future employees for students to never actually work there. This will hurt the relationships between firms and accounting schools because they will be skeptical to hire students from that school in the future.

Even though I would never encourage a student to pursue law school instead of becoming a CPA, if a student is one hundred percent certain that they want to pursue a career in tax law and plan to go straight to law school after undergrad with no accounting internship, I now think that is okay. Everyone is different and has different future outlooks. I do believe that it is more limiting, but there is a chance for greater compensation in the future, so I understand the attraction to it.

Scenario 2:

In scenario 2, a student expresses that she hates being an accounting major and wants to pursue a career in investment banking. She expresses that she is only an accounting major because the school is so highly ranked, and she will have a better chance at getting a job upon graduation. As far as my position on this scenario, I completely understand this perspective. Accounting is a very challenging major, so it looks great on a resume, especially if it's from a top-ranked school like Ole Miss. It is also a very diverse major that is in no way limiting on what future career one can have with it. As long as this student is a high performer in her first accounting job, she will have many options for an investment banking job. The only potential issue I have with this situation is if the student decided to take an accounting internship but did not go back and work her fair share of time at that accounting firm. Similar to Scenario 1, I believe it is highly unethical to let a firm spend that much time and money to train and recruit a potential employee and that person not stay to complete their end of the deal. It is rare for one to spend a lifetime working at one single accounting firm, so if this student can stick it out for a few years at a firm, it is highly likely that she will get a job with a client in another industry anyway.

This scenario is different than Scenario 1 because a student pursuing an accounting degree to work in a different field is generating a larger field of potential career options. It is commonly said that accounting is the language of business, so an accounting degree gives students options in endless fields, whereas a law degree is limited to just that field.

Scenario 3:

In scenario 3, a student had just done his senior internship in Washington, D.C. However, he realized that he did not want to be there full time and reached out to a former teacher for help to switch his offer to the firm's Dallas location, his hometown. This is a common scenario with college students since they have to essentially decide their future at age 21. I think it was a good idea for the student to reach out to his former teacher since it is likely that she would have helpful hints on how to go about asking for this switch. However, I cannot fully side with the student for wanting to switch locations. This student was originally from Dallas and knew that he would eventually end up back there, so if he was not willing to be away from home he should not have chosen a location so far away. I understand that he wanted to get out of his comfort zone, but he should have put more thought into his decision about going to D.C. It is imperative that one chooses a city that they are certain they can live in for a minimum of three years. The D.C. office has already spent large quantities of time and money on him and would be at a loss if he switched to Dallas. Also, Dallas is quite a competitive city to work in, so it would be difficult for the firm to simply give him a position there.

A possible solution to this student's conflict, in my opinion, is to stay in the Washington, D.C. office, prove himself to be a high performer, and get the opportunity down the road to switch back to his hometown. This would not likely be the news this student wants to hear, but he is likely open to the idea of being away from home if he initially chose D.C. as his primary location. If he wanted to be in Dallas bad enough he would have chosen it first. This student should work hard, be a high performer in D.C., and then talk to his managers to possibly make the switch to Dallas in the near future.

Case #4 - Generic Bank: Accounting for Debt Securities Sales and Impairments

Purpose

This case guided students through decision making relating to available for sale debt securities in a bank setting. For many of the requirements a distinct answer was not available, and it was up to students to use personal judgement on how to treat each individual situation. Students were encouraged to seek out FASB guidance in ASC 326-30, along with other research, to help make determinations for how securities are to be accounted for in different situations. This case also helped students to put themselves in the shoes of different people involved in the process to enable them to see each how each situation would change if they saw it from a different perspective.

Takeaway

Prior to beginning this case, I had no knowledge on the topic of debt securities and I especially did not know how to determine impairment or how to treat the securities in various situations. I am now much more aware of debt security behavior and possible judgements that have to be made regarding them. Aside from learning about the topic itself, I also learned how to use the FASB Codification to find guidance on issues that do not have a clear answer. Previously, I had never been faced with an accounting issue that did not have a set answer. This case prepared me for the future when I will run into similar issues where I will have to use my own judgement in treating a situation. I was presented with several challenges while completing this case and I was forced to use several outside sources as well as critical thinking. This will be helpful for me in my future career as I am certain I will have many tasks that challenge me to go outside my comfort zone to find solutions.

a. Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 2013. Does Generic Bank have an impairment loss on the seven securities designated above in 2012?

Generic bank does have an impairment loss on the seven securities. The net fair value of the securities is below the amortized cost on 003, 015, 025,030, and 076. The decline in value of the debt securities is due to cyclical changes in interest rates and not because of credit losses. According to ASC 326-30-55-1, Generic Bank does not meet the requirements for loss in value because of credit losses according to the information given. Nothing is stated about the security rating, ability of borrowers to make payments, or changes in technology. Since it can be reasonably determined that these losses were due to cyclical changes and not credit losses, the intent of the bank is the next determination. Since Joshua Winters identified securities 003, 015, 025,030, 067, 076 and 096 for sale, the bank had the intent to sell these securities and cannot make the argument that they were going to hold them to maturity. Because of this the securities are deemed impaired and need to be written down to fair value.

This impairment loss should be reported in 2012 because Winters had the intent to sell at the end of 2012 even though they reported that they had the intent to hold. The aforementioned securities were held for sale at the end of the year, but Generic Bank did not report intent to sell and instead reported that they had the intent and ability to hold the securities until they matured or unrealized losses recover. According to ASC 320, Generic Bank meets the requirement that says, "The security is sold shortly after the balance sheet date and facts and circumstances suggest that the decision to sell was made before the balance sheet date," (FASB). Because Generic Bank has to report the impairment loss on the seven securities, this would decrease net income by $54,209,000, which is material for the bank.

b. **Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 2013. Does Generic Bank have an impairment loss on securities other than the seven securities sold? If so how would you determine the extent of the impairment?**

Generic Bank does not have an impairment loss on securities other than the seven sold. Even though the reduction in value is due to interest rate changes and not credit losses as established in part one, the rest of the securities outside of the seven are not intended to sell. Therefore, it can be assumed that they are going to be held to maturity or until unrealized losses are recovered, especially since no impairment losses were reported on the most previous balance sheet. It is not necessary for Generic Bank to sell the remaining securities because they have several other ways to raise liquidity such as FHLB advances and Fed Funds. Because of these conditions defined in ASC 326-30, Generic Bank can get away with not reporting the losses on these securities until they are sold or put up for sale. It may be misleading to investors to not report these losses, but it is not required under FASB guidance.

c. **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?**

From the auditor's standpoint, the answer does not change. According to ASC 326-30, if a debt security is below fair value because of changes in interest rates, not credit losses, and has the intent to sell them then they should be discounted to fair market value. However, if the company only sells the seven securities previously mentioned and not the others, then they do not have to report an impairment loss on them since they are not intended to sell, but to either mature or for interest rates to change. An auditor's job is to ensure accuracy on financial statements and make sure they are in accordance with GAAP, so in the auditor's eyes the financial statements are correct.

However, assuming the role of a bank regulator, the answer might change. According to the job description of a bank regulator by Adrien Morrissey from the Robert Walters Company, one of the most important aspects of a compliance officer, or bank regulator, is to be ethical and credible. In this case, it is unethical not to report the losses on securities because the bank is unsure whether it will hold them or sell them. A bank regulator would advise the bank to report the losses even if there was only a slight possibility that they would put them for sale because the impairment losses affect the financial statements significantly and they are currently misleading investors.

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

If every security sold was in a gain position, then no impairment losses would be reported because amortized cost has to be less than fair value and it would not be. However, if the securities had been sold at a collective net gain, there were still five securities that had an impairment loss. These individual securities were impaired, but collectively the bank could have reported a gain on the sale. However, selling securities at a collective gain within a certain time period and not disclosing the impairment losses is unethical because of the concept of gains trading. According to the FDIC, gains trading is defined as, "the purchase and subsequent sale of a security at a profit after a short holding period, while securities acquired for this purpose that cannot be sold at a profit are retained in the AFS or HTM portfolio," (FDIC). Banks typically practice gains trading to defer loss recognition into the future since losses are not reported into income until they are for sale. Basically, this means that it is unethical for a bank to report its gains on the sale of securities and then not report the losses on its securities that are not for sale because it gives an unfair portrayal of the bank's financial position. The FDIC encourages bank regulators to scold banks who do this because it gives an untrue representation of the bank's state. If the bank didn't report the impairments and only reported the gains to cover up those losses, then an ethical issue comes to play and the bank regulator would have a different response on reporting than an external auditor would.

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

Generic Bank will have an impairment loss on the securities other than the seven because they will more than likely have to sell securities out of necessity because they will not recover the amortized cost before they mature, or they will have to sell them to meet liquidity requirements. According to ASU 326-30-35-10, "If an entity does not intend to sell the debt security, the entity shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before a the forecasted recovery occurs)," and according to the given information, the bank will likely be required to sell the securities to meet requirements. This does not, however; change the classification of impaired securities because if a security's amortized cost is lower than fair market value and is for sale then it is impaired no matter the situation. Also, it is not likely that Generic Bank will be able to hold these until the interest rates go back down. It will likely take years for the interest rate to change and they will probably have to sell the securities to gain liquidity before then. They should report these losses in 2012 if they are aware of their adequately capitalized nature and not wait until they are forced to sell the securities.

f. **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?**

From the auditor's standpoint, the answer does not change. According to the (insert something here), if a debt security is below fair value because of changes in interest rates, not credit losses, and has the intent to sell them then they should be discounted to fair market value. However, if the company only sells the seven securities previously mentioned and not the others, then they do not have to report an impairment loss on them since they are not intended to sell, but to either mature or for interest rates to change. An auditor's job is to ensure accuracy on financial statements and make sure they are in accordance with GAAP, so in the auditor's eyes the financial statements are correct.

However, assuming the role of a bank regulator, the answer might change. According to (Robert Walters.com), one of the most important aspects of a compliance officer, or bank regulator, is to be ethical. In this case, it is unethical not to report the losses on securities because the bank is unsure whether it will hold them or sell them. A bank regulator would advise the bank to report the losses even if there was only a slight possibility that they would put them for sale because the impairment losses affect the financial statements significantly and they are currently misleading investors.

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

If every security sold was in a gain position, then no impairment losses would be reported because amortized cost has to be less than fair value and it would not be. However, if the securities had been sold at a collective net gain, there were still 5 securities that had an impairment loss. These individual securities were impaired, but collectively the bank could have reported a gain on the sale. However, selling securities at a collective gain within a certain time period and not disclosing the impairment losses is unethical because of the concept of gains trading. According to the FDIC, gains trading is defined as, "the purchase and subsequent sale of a security at a profit after a short holding period, while securities acquired for this purpose that cannot be sold at a profit are retained in the AFS or HTM portfolio." (Banks typically practice gains trading to defer loss recognition into the future since losses are not reported into income until they are for sale. Basically, this means that it is unethical for a bank to report its gains on the sale of securities and then not report the losses on its securities that are not for sale because it gives an unfair portrayal of the bank's financial position. The FDIC encourages bank regulators to scold banks who do this because it gives an untrue representation of the bank's state. If the bank didn't report the impairments and only reported the gains to cover up those losses, then an ethical issue comes to play.

Now assume that Generic Bank is adequately capitalized rather than well capitalized. And the bank desires to sell securities to improve capital ratios (through the reduction of risky assets) and to fulfill other borrowing obligations as they come due. Securities may not represent the only assets available to Generic Bank to sell, but access to other forms of borrowing to meet liquidity needs has become more limited.

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

Generic Bank will have an impairment loss on the securities other than the seven because they will more than likely have to sell securities out of necessity because they will not recover the amortized cost before they mature, or they will have to sell them to meet liquidity requirements. According to ASU 326-30-35-10, "If an entity does not intend to sell the debt security, the entity shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before a the forecasted recovery occurs)," and according to the given information, the bank will likely be required to sell the securities to meet requirements. This does not, however; change the classification of impaired securities because if a security's amortized cost is lower than fair market value then it is impaired no matter the situation. Also, it is not likely that Generic Bank will be able to hold these until the interest rates go back down. It will likely take years for the interest rate to change and they probably will have to sell the securities to liquidate before then. They should report these losses in 2012 if they are aware of their adequately capitalized nature and not wait until they are forced to sell the securities.

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Case #5 - City Scenarios

Purpose

The purpose of this case was to get students in the right mindset when choosing their eventual city for their internship and first job. Choosing a city is a big decision for accounting students since we are expected to stay for a minimum of 3-5 years. Many students blindly choose a city with little reason to support their choice. This case allowed students to think deeply about each of their top two cities and consider many things that would have probably gone unconsidered otherwise. These things included taxes, laundry, grocery shopping and transportation options. All of these requirements were to push students out of their comfort zones and think seriously about where they might want to start their careers.

Takeaway

This case was extremely beneficial to me in a unique way. It did not help my understanding of the work of my career, but the environment surrounding it. I thought I was completely set on my top city, but after I completed the case I am now more torn than I expected to be. This case prompted me to consider so many specific things about each city that I was not previously considering. My main points were ability to grow, size of the city, and personal connection, but I realized so many other things that are necessary to choosing a place to start my career. Things like taxes, transportation, climate and industries in the area never came into my considerations before this case. My second city is now a top contender after all things considered. I realized that I do care about being far from my family and I am particular about the climate I live in. Even though completing this case complicated my decision rather than solving it, I will now think deeper about it and I know I will make the correct informed decision.

Preferred City 1: Chicago, Illinois

Preferred City 2: Tampa, Florida

I. **Population:**

a. Chicago: In the Metropolitan area, Chicago has 9,533,040 people.

b. Tampa: In the Metropolitan area, Tampa has 3,068,511 people.

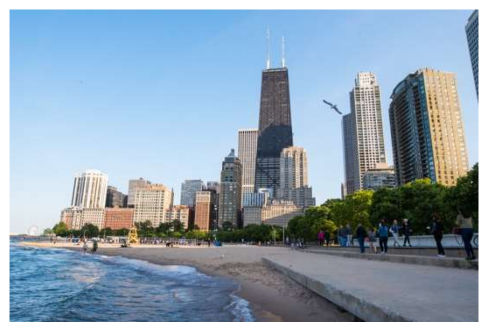
II. **Climate and Seasonal Fluctuations**

a. Chicago: Winter lasts from November through April and comes with very cold and snowy winters with highs in the 30s and below. Chicago has mildly warm summers with highs in the low 80s.

b. Tampa: Summers are hot and humid with highs in the 90s. Tampa's winters are still warm with highs averaging in the 70s. Snow is extremely rare.

III. **Topography, Scenery, and Other Geographic Features**

Figure 5-1: Chicago Geography



a. Chicago: The city is very metropolitan with thousands of high rises. The land itself is very flat, with no hills or mountains in the city or surrounding areas. There are lots of green trees that lose their leaves in the fall with several green areas surrounding the city. Lake Michigan borders the city to the east and there are many man-made beaches along the shore. The Chicago river also runs through the middle of the city.

Figure 5-2: Tampa Geography

b. Tampa: The city sits on the Tampa Bay which is a part of the Gulf of Mexico, so there is water surrounding most of the city meaning many white sand beaches. The downtown area has a few high-rise buildings, many of which have a view of the water. The main vegetation is palm trees and small bushes.

IV. Individual tax rates within the city (federal, state, local income tax, property tax and any other taxes likely) based on a starting salary of $50,000.

a. Chicago: $11,831 is the total federal, state, FICA and local income tax. Property taxes will be $7,261 and the average sales and fuel taxes will be $935 and $214 respectively. This would mean the annual tax burden would be close to $20,240.

b. Tampa: $9,464 is the total Federal, FICA, and Local income taxes. Florida has no state income tax. Sales taxes are estimated to be $993 and Fuel taxes are estimated to be $277 annually. Property taxes will be around $2,658. These all total to be around $13,395 per year in taxes.

V. Transportation Hubs in the City

a. Chicago: To get around the city, the easiest modes of transportation are the EL train the Metra train, or by taxi. If I live in the city, I will have a monthly public transportation pass. A car will not be needed and would be more of a burden than a help because of limited parking and heavy traffic. There are also two major airports in the city to make travel convenient.

b. Tampa: There is a public bus system, however the easiest way to get around is by car since the commute times and traffic are not too much of a burden. There is a major airport in the city as well.

VI. Prevalent Industries

a. Chicago: Manufacturing, printing and publishing, finance and insurance, and food processing a few of the main industries. Chicago is also the home of the Federal Reserve Bank, the Chicago Board of Trade and the Chicago Mercantile.

b. Tampa: Financial Services (Raymond Services), Tourism, Steel Industry, Marines Sciences, Manufacturing, Business and Information Systems, and Healthcare are the major industries.

VII. Healthcare

a. Chicago: Healthcare is a $70 Billion industry in Chicago with 26,000 Healthcare-related companies in the area. There are 19 hospitals in the area with five being university hospitals. Because of this, it can be inferred that the quality of healthcare in the area is superior to that of the rest of the state.

b. Tampa: There are 20 of the nation's top hospitals in the area. Also, there are several healthcare companies that have headquarters there, so the quality is superior relative to the surrounding areas.

VIII. Crime and Areas to Avoid

a. Chicago: Downtown, The Loop, tourist areas, and suburbs north of the city are safe. The south side of the city should be avoided as this is where the highest crime rates and deaths occur annually. The south side accounts for the majority of the crimes that give Chicago the reputation for being a dangerous city.

b. Tampa: Tampa is ranked as one of the safest cities in the United States and is one of the few cities where violent crime has steadily decreased over the last decade.

East Tampa that should be avoided as that is where the highest crime rates are. One should also be careful to check tabs at restaurants as it is common for restaurants to unfairly upcharge people who they think might be tourists.

IX. Rent/Living Arrangements

a. Chicago: In Chicago, I would rent an apartment similar to the one shown in figures three and four in the Lincoln Park area just north of downtown where many young professionals live. I would have a roommate and I expect to pay around $1,100 monthly. This specific apartment is 1,000 square feet, newly renovated, with two bedrooms and one bathroom. It has an

in-unit washer and dryer and has parking that can be purchased for an additional charge.

Figure 5-3: Chicago Living (exterior)

Figure 5-4: Chicago Living (kitchen)

b. Tampa: In Tampa, I would rent a house similar to the one shown in figures five and six. There are very few apartments for rent that would fit my budget of $1,00 per month, so it would be easier and more convenient to have a house with a roommate. The one shown would be $1,300 if I had one roommate or $870 if I had two roommates. It is 2,400 square feet, newly renovated, lawn care is included and has a laundry room. It is also only a ten-minute drive to downtown.

Figure 5-5: Tampa Living (exterior)

Figure 5-6: Tampa Living (interior)

X. Mode of Commuting/Commute Time

a. Chicago: I will take the train from my apartment to the station nearest to my office and then walk the rest of the way. The commute will be around 30 minutes.

b. Tampa: I will have a car and the commute will be 15-20 minutes in the middle of rush hour traffic.

XI. Grocery Shopping

a. Chicago: There is an Aldi half a mile away from the property I listed above, so that would likely be where I do my grocery shopping since it is the closest and most convenient.

b. Tampa: Publix is the most common grocery store since it is headquartered there. There is a Publix six minutes away from the property I listed above.

XII. Laundry

a. Chicago: I will make sure that I only get an apartment with an in-unit washer & dryer like the one I listed above since I will likely not have time to go to a laundromat during the start of my career.

b. Tampa: I will make it a priority to have an in-house washer & dryer like the property I listed above so I can do my laundry at my convenience.

XIII. Civic, Religious and Charitable Organizations

a. Chicago: I will be a part of Junior League of Chicago, which promotes social activism of young women. I will be a part of the Big Shoulders Fund, which advocates for children to have quality education and I will also be a member of Park Community Church.

b. Tampa: I will be a part of Crossover church and I will volunteer for Chicktime, an organization that encourages women and young children to better their current neglected situations. I will also volunteer with Junior Achievement's Biztown. This is an organization that allows elementary school students the chance to "play adult" for a week where they run a mock town to give them a start on considering a future job.

XIV. Sports, Entertainment and Recreational Activities

a. Chicago: In Chicago I would attend Chicago Cubs baseball games and Chicago Blackhawks Hockey games. I would play golf at the many superior golf courses around the city. I would also go to shows at Chicago Theater, Second City comedy club, along with attending the numerous nationally acclaimed museums.

b. Tampa: In Tampa I would play golf and go to the beach often as the weather is so beautiful. I would attend Tampa Bay Buccaneers games as well as watch MLB spring training games and I would also have a season pass to the Busch Gardens theme park.

XV. Travel Home

a. Chicago: From Chicago I would have to fly home to West Palm Beach, Florida. The flights average to be $450 round trip. Since I love warm weather, I will likely visit as often as I can to escape Chicago's frigid winters.

b. Tampa: From Tampa I would drive home. It is a three-hour drive from Tampa to West Palm Beach, so it would take two tanks of gas which is about $80.

XVI. Monthly budget for year 2 based on $60,000:

a. Chicago:

Figure 5-7

Item	Amount ($)
Take home pay after taxes	3,315
Housing	1,100
Public Transportation	125
Utilities	55
Cell Phone	65
Groceries	215
Dining	415
Entertainment	165
Savings	670
Travel	300
Other (clothing, emergencies, etc.)	205

b. Tampa:

Figure 5-8

Item	Amount ($)
Take home pay after taxes	3,880
Housing	1,100
Transportation (Gas and Insurance)	365
Utilities	50
Cell Phone	65
Groceries	300
Dining	415
Entertainment	290
Savings	785
Travel	210
Other (clothing, emergencies, etc.)	300

XVII. Preferred city

After analysis, I can see myself in both cities. The two are polar opposites and have different strengths, which makes it even harder to determine which is my overall favorite. Chicago has infinite opportunities for growth and a much wider range of industries and connections to be made. The major downfalls, however; are the cold climate, the high tax rates and the long distance from home. Tampa is more limited on opportunities to grow, but has the perfect climate, no state income tax and is only a short car ride away from home. I will likely still put Chicago as my top city simply because of the vast opportunities it offers and the experience of living somewhere different than what I am used to, while also having extended family close. Tampa will still be a close second choice since it has everything I am looking for in a city but might be limited when it comes to my future growth potential.

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Case #6 - WorldCom

Purpose

This case provided an in-depth analysis of the accounting misstatements that WorldCom did in 2001 to incorrectly overstate its net income. Students were guided through the thought process that WorldCom's executives went through in trying to hide their sharp decline in income. Students had to think through what the true definitions of assets and expenses and when it is acceptable to capitalize an asset rather than expense it. In the end students learned that WorldCom capitalized the use of another company's lines for operations rather than expensing them to boost the net income in 2001 from a large loss to a gain. The overall point of this case was to point out how easy it can be to bend the truth to boost financial statement outcomes, but the benefits will never outweigh the punishments that will come after the misstatements are realized.

Takeaway

Although this case involved several calculations and critical thinking, the main takeaway for me was about the importance of ethics in accounting. WorldCom was one of the largest companies in the 1990s and early 2000s, but quickly fell to ruin because of the unethical behavior of its executives. The communication business started to falter in the early 2000s and WorldCom wanted to meet projections, so they felt the only option for them was to misstate their financial statements rather than accept their net loss. In the end, the company was closed, and the executives were not allowed to hold any position in a large company or be CPAs again. These punishments were not worth the gains in the end and it goes to show that committing fraud will never put you ahead. In the future, I will work with my superiors to determine a legal action plan to improve financials rather than taking the unethical route like the executives at WorldCom.

b. 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.

1. **Explain in your own words how SCON 6 defines asset and expense.**

    An asset is something owned by an entity that comes from a past transaction that adds value to the entity and is available meet current or long-term debts or commitments. An expense is a cost that is part of a company's current operating activities that involves the outflow of assets to meet liabilities that contribute to the entity's ongoing central operations.

2. **In general, when should costs be expensed and when should they be capitalized?**

    Costs should be capitalized if they improve the asset and extend its future benefit. For costs to be capitalized they have to meet at least one of the following three conditions: the useful like of the asset must be increased, the quantity of service that the asset produces must increase, or the quality of units produced must be improved. A cost should be expensed if it pertains to the normal maintenance of an asset and does not meet any of the three criteria above.

c. 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.

These costs are depreciated over time and incur a portion of the expense every year. These expenses are debited to depreciation expense and credited to accumulated depreciation. These entries cause net income to be higher in the year of acquisition since the costs are not expensed immediately. The entry will cause assets to decrease since accumulated depreciation decreases the value of an asset.

d. 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.

In 2001, WorldCom reported $14.739 billion as line costs, which is the exact number it reported in 1999. These line costs allowed WorldCom to carry out their ongoing operations and included access to transport equipment owned by another company.

Line Cost Expense	14,739	
Cash		14,739

e. 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?

The costs that were improperly capitalized by WorldCom were not recognized in detail by the company, but according to the article they were made up of access and transport charges that related to the company's ongoing operations. These costs were expenses and should not have been capitalized since they had to do with the ongoing operations of the company and did not extend the life of and asset, did not increase the quality of products produced and did not increase the quantity of goods produced. These costs also do not meet the definition of an asset since they paid another company to use their equipment and did not own the equipment itself. Transactions that gave rise to these costs would have involved WorldCom giving up cash and receiving access to transport lines.

f. 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?

Transmission Equipment	3,055	
Line Cost Expense		3,055

These costs appeared on the balance sheet as transmission equipment but would not be on the statement of cash flows until the end of the next year when depreciation expense is recognized.

g. 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.

Depreciation Expense	83,306,819	
Accumulated Depreciation		83,306,819

771,000,000/22*4/4= 35,045,455	
610,000,000/22*3/4= 20,795,455	
743,000,000/22*2/4= 16,886,364	
931,000,000/22*1/4= 10,579,545	
Total	$83,306,819

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

Income before Income Taxes	$2,393,000,000
Improperly Capitalized Line Costs	(3,055,000,000)
Depreciation Expense	83,306,819
Net Loss Before Tax	(578,693,181)
Income Tax Benefit	202,542,613
Minority Interests	35,000,000
Net Loss	$(341,150,568)

This difference is very material. WorldCom originally had a net income of $1.5 billion when they actually had a net loss of over $340 million.

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Case #7 - Analyzing the Financial Statements of Starbucks

Purpose

The purpose of this case was to enhance students' understanding of financial statement analysis of public companies as well as understanding some of the peripheral steps that go into constructing financial statements. This case required the application of conceptual as well as quantitative knowledge to complete. Not only was it necessary to understand the numbers and where they came from, but it was also necessary to understand why they are what they are. Students had to pay close attention to detail in understanding whether each quantity was "normal" or unusual. This case was comprehensive of our knowledge to date and created links between concepts that were previously unrelated. This case also tied in the work of the actual accounting profession by requiring the analysis of two audit assurance letters. This gave students a small glimpse of some work that auditors do on a daily basis.

Takeaway

I benefitted from completing this case because it was quite applicable to real world accounting. Personally, I am more interested in doing audit work and this case was focused on work that auditors typically do. I was able to read and analyze two audit letters and also delve into financial statements to analyze them. I found it very beneficial to be able to create links in information that I have learned in class that I did not know were relevant to each other. For example, I have previously done common size financial statements and I have learned specifically about financing, but I have never been able to connect the two in the case of what percentage of a company is financed by debt or equity. This case included multiple types of financial statements and allowed me to make connections between them. There were a few connections I have never made before and I will now be able to make them immediately.

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

Starbucks is in the business of selling coffee and related products. This includes a wide array including things like made to order coffee drinks in stores, take-home coffee in the form of beans, grounds and Keurig pods, as well as individually packaged drinks in grocery and convenience stores. Also sold in the Starbucks store locations are baked goods and coffee accessories like mugs. Starbucks prides itself on being a "high-end" coffee shop and takes its image and quality seriously. Overall, Starbucks makes its money from the sale of goods, so their biggest expense should be cost of goods sold.

b. **What financial statements are commonly prepared for external reporting purposes? What titles does Starbucks give these statements? What does "consolidated" mean?**

Typical external financial statements include the Balance Sheet, Income Statement, Statement of Cash Flows, Statement of Comprehensive Income, and Statement of Stockholders' Equity. Starbucks reports all of these but "consolidated". This means that Starbucks reports the financials of all its subsidiaries into one statement rather than separate statements for each. Some of the most well-known subsidiaries include Teavana, Seattle's Best Coffee, and Tazo. Consolidated statements present more easily and more fairly the true outcomes of the company for the period.

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

Companies typically report their financials every quarter which falls on the end of March, June, October, and December.

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

Starbucks' upper level management team is responsible for preparing their financial statements to the best of their ability, just as every company that has to file with the SEC. The statements are then checked over by internal and external auditors to assure that the information presented is accurate and within GAAP standards. The main users of the statements listed in part (c) would include anyone with a stake in the company like creditors, stockholders and bondholders. Potential investors or competitors sometimes look at financial statements as well to make future decisions, but this is less often than those who have a direct stake in the company.

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

Starbucks' external auditors are from the Seattle office of Deloitte & Touche LLP. The first opinion letter provides reasonable assurance that the financial statements are "free of material misstatement" backed up by tests that support the amounts and disclosures. The letter also states that the audit has been performed up to PCAOB (Public Company Accounting Oversight Board) standards. The second letter is attesting to the effectiveness of Starbucks' internal controls. They tested the risk, material weaknesses, design and overall effectiveness of the internal controls in place. They disclosed that not all collusion, error, or fraud can be detected, but they overall gave reasonable assurance that they believe Starbucks' internal controls are within the guidelines of COSO's

(Committee On Sponsoring Organizations) internal control framework. These letters are dated several weeks after fiscal year end because the audit cannot take place until all of the data from the year is set in stone and received. Because an audit cannot be done overnight, the auditors need several weeks to perform the year-end audit, which causes the financial statements to be filed after year-end. Overall, Deloitte issued an unqualified opinion on the financial statements.

f. Use a spreadsheet to construct common-size income statements (which Starbucks calls statements of earnings) and balance sheets for 2013 and 2012. Common-size income statements scale each income statement line item by total *net* revenues (sales). Common-size balance sheets are created by dividing each figure on a given year's balance sheet by that year's total assets, thereby creating a balance sheet on a "percent of assets" basis.

See Table 1 and Table 2.

Figure 7-1

Consolidated Statements Of Earnings (USD $)	12 Months Ended			
In Millions, except Per Share data, unless otherwise specified	**Sep. 29, 2013 Actual Numbers**	**Sep. 29, 2013 Percentages**	**Sep. 30, 2012 Actual Numbers**	**Sep. 30, 2012 Percentages**
Net revenues:	'		'	
Company-operated stores	$11,793.20	79.2%	$10,534.50	79.2%
Licensed stores	1,360.50	9.1%	1,210.30	9.1%
CPG, foodservice and other	1,738.50	11.7%	1,554.70	11.7%
Total net revenues	14,892.20	100.0%	13,299.50	100.0%
Cost of sales including occupancy costs	6,382.30	42.9%	5,813.30	43.7%
Store operating expenses	4,286.10	28.8%	3,918.10	29.5%
Other operating expenses	457.2	3.1%	429.9	3.2%
Depreciation and amortization expenses	621.4	4.2%	550.3	4.1%
General and administrative expenses	937.9	6.3%	801.2	6.0%
Litigation charge	2,784.10	18.7%	0	0.0%
Total operating expenses	15,469	103.9%	11,512.80	86.6%
Gain on sale of properties	0	0.0%	0	0.0%
Income from equity investees	251.4	1.7%	210.7	1.6%
Operating income	-325.4	-2.2%	1,997.40	15.0%
Interest income and other, net	123.6	0.8%	94.4	0.7%
Interest expense	-28.1	-0.2%	-32.7	-0.2%
Earnings before income taxes	-229.9	-1.5%	2,059.10	15.5%
Income taxes	-238.7	-1.6%	674.4	5.1%
Net earnings including noncontrolling interests	8.8	0.1%	1,384.70	10.4%
Net earnings attributable to noncontrolling interest	0.5	0.0%	0.9	0.0%
Net earnings attributable to Starbucks	$8.30	0.1%	$1,383.80	10.4%
Earnings per share - basic	$0.01	0.0%	$1.83	0.0%
Earnings per share - diluted	$0.01	0.0%	$1.79	0.0%
Weighted average shares outstanding:	'	5.0%	'	
Basic	749.3	5.0%	754.4	5.7%
Diluted	762.3	5.1%	773	5.8%
Cash dividends declared per share	$0.89	0.0%	$0.72	0.0%

Figure 7-2

Common Size Balance Sheets (USD $) In Millions, unless otherwise specified				
	Sep. 29, 2013 Actual Numbers	Sep. 29, 2013 Percent of Assets	Sep. 30, 2012 Actual Numbers	Sep. 30, 2012 Percent of Assets
Current assets:	'		'	
Cash and cash equivalents	$2,575.70	22.4%	$1,188.60	14.5%
Short-term investments	658.1	5.7%	848.4	10.3%
Accounts receivable, net	561.4	4.9%	485.9	5.9%
Inventories	1,111.20	9.6%	1,241.50	15.1%
Prepaid expenses and other current assets	287.7	2.5%	196.5	2.4%
Deferred income taxes, net	277.3	2.4%	238.7	2.9%
Total current assets	5,471.40	47.5%	4,199.60	51.1%
Long-term investments	58.3	0.5%	116	1.4%
Equity and cost investments	496.5	4.3%	459.9	5.6%
Property, plant and equipment, net	3,200.50	27.8%	2,658.90	32.3%
Deferred income taxes, net	967	8.4%	97.3	1.2%
Other assets	185.3	1.6%	144.7	1.8%
Other intangible assets	274.8	2.4%	143.7	1.7%
Goodwill	862.9	7.5%	399.1	4.9%
TOTAL ASSETS	11,516.70	100.0%	8,219.20	100.0%
Current liabilities:	'		'	
Accounts payable	491.7	4.3%	398.1	4.8%
Accrued litigation charge	2,784.10	24.2%	0	0.0%
Accrued liabilities	1,269.30	11.0%	1,133.80	13.8%
Insurance reserves	178.5	1.5%	167.7	2.0%
Deferred revenue	653.7	5.7%	510.2	6.2%
Total current liabilities	5,377.30	46.7%	2,209.80	26.9%
Long-term debt	1,299.40	3.1%	549.6	6.7%
Other long-term liabilities	357.7	3.1%	345.3	4.2%
Total liabilities	7,034.40	61.1%	3,104.70	37.8%
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	0.8	0.0%	0.7	0.0%
Additional paid-in capital	282.1	2.4%	39.4	0.5%
Retained earnings	4,130.30	35.9%	5,046.20	61.4%
Accumulated other comprehensive income	67	0.6%	22.7	0.3%
Total shareholders' equity	4,480.20	38.9%	5,109	62.2%
Noncontrolling interests	2.1	0.0%	5.5	0.1%
Total equity	4,482.30	38.9%	5,114.50	62.2%
TOTAL LIABILITIES AND EQUITY	$11,516.70	100.0%	$8,219.20	100.0%

g. **i. Demonstrate that the accounting equation holds for Starbucks. Recall that the accounting equation is: Assets = Liabilities+Equity.**

Assets= $11,516.70

Liabilities= $7,034.40

Equity= $4,482.30

Liabilites+Equity= $11,516.70

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

Starbucks' major assets are cash and property, plant and equipment. The ratio of short term assets to total assets is 47.5 percent and the ratio of long term assets to total assets is 52.5 percent. This does seem appropriate for Starbucks since its business is based on preparing and selling inventory. Their inventory is produced by property, plant and equipment so it seems fair that their short-term assets almost equal their long-term ones.

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

Intangible assets are assets that cannot be physically handled but add value to the company. Goodwill is the residual value of the company after everything has been valued. It can only be recognized when a company is sold and is not separately identifiable to individual assets. Starbucks likely has copyrights, patents, and trademarks for its products, brand name, and graphics.

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

Starbucks is financed mostly by equity. Starbucks' stockholders' equity is almost 40 percent of total liabilities and equity whereas long term liabilities only account for about 6 percent. About 15 percent of financing comes from nonowner sources.

h. Refer to Starbucks' statement of earnings for fiscal 2013 (the year ended September 29, 2013) and to the common-size income statement you developed in part *f*, above.

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

Starbucks uses the accrual basis. This is inferred by the discussing of using the net method- a way of recognizing revenue before consideration is given up. Starbucks records revenue of stored value cards when redeemed or when the likelihood of redemption is remote. Any outstanding balance is a part of deferred revenue on the balance sheet. These stored value cards require judgement on management's part as there has to be a determination of "remote" and "inactive". If management deems the card will not be redeemed then they recognize the revenue sooner, but that determination is vague.

ii. What are Starbucks' major expenses?

Starbucks' major expenses for 2013 include cost of goods sold, store operating expenses, and a litigation charge. Costs of goods sold included all the costs of beverages and food as well as the gifts sold in store. Operating expenses include costs of labor for the workers in store.

iii. Were there any significant changes in cost structure in the current year?

There do not seem to be any significant changes in cost structure for 2013. The percentage of expenses to revenues was similar to that of the previous year except for a new expense labeled "litigation charge".

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

The litigation charge arose when Starbucks prematurely ended a contract with Kraft, who was selling Starbucks products to grocery stores. This litigation charge will only appear for the year 2013, so it is an operating expense, but is not a part of general and administrative expenses since it was not involved with the ordinary operations of Starbucks.

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

During 2012, Starbucks was profitable with a net income of $1.384 billion. In 2013, Starbucks had a net income of $8.8 million. These figures both include noncontrolling interests. In 2013 Starbucks was profitable since they did not have a loss for the year, however they did not profit to the extent in which they planned for.

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

Starbucks' net earnings were $8.8 million and its net cash from operating activities was $2908.3 million. The ratio is about 0.3 percent, which without the litigation charge would be much higher. Since the company's earnings for the year were so low, the ratio is skewed for the year. The previous year's ratio was nearly 80 percent, so it is a huge difference that is mostly attributable to the litigation charge. However, depreciation and amortization expense increased by nearly $70 million in 2013. This number was relatively constant in previous years, so this added expense also contributes largely to the smaller ratio for 2013.

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

Starbucks invested $1151.2 million in property, plant and equipment in total for the year. Total property, plant and equipment increased by $541.6. Even though both of these increased, as compared to the previous year's total property, plant and equipment as a percent of assets, 2013's ratio was less than the previous year's total assets. The total for 2012 was 32.3 percent and the total for 2013 was 27.8 percent.

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

During the year Starbuck's declared $666.88 million of dividends and actually paid $628.9 million in dividends. On the statement of earnings, dividends declared are $668. 6 million. A company does not have to pay all of its dividends and therefore will have 39.7 of dividends payable to carry forward into the next year.

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

As per the notes, Starbucks uses estimates for asset and goodwill impairments, stock-based compensation forfeiture rates, future asset retirement obligations, and inventory reserves. Some other estimates include allowance for doubtful accounts, self-insurance, values for stored value cards and future tax consequences. Almost every account requires the use of an estimate whether it be related to assets, liabilities, revenues or expenses. For example, inventories have to be estimated and assets and their depreciation have to be estimated. There is no account that is completely straightforward without any use of estimates.

Case #8 - BP Oil Spill and Contingent Liabilities

Purpose

The purpose of this case was to enhance students' knowledge of contingent liabilities and how they can significantly affect the financial position of a company. Contingencies require a great deal of judgement by management since they are future events that are not guaranteed to occur, and their amounts can only be estimated. Contingent liabilities such as warranty expenses can be fairly reasonably estimated since they are a frequent occurrence for most companies. However, litigation charges are much harder to determine, and that is what the bulk of this case focused on. BP had to estimate the amount of damages that were to be reasonably paid to those affected by the 2010 oil spill. Since there were secondary effects on almost every industry on the United States Gulf Coast, it was hard to draw the line on what damages were necessary to be paid and which ones were not.

Takeaway

This case allowed me to get more insight into qualitative accounting issues rather than simply quantitative issues. I was able to critically think and put myself in the shoes of an actual auditor for this case. The events of the BP oil spill greatly affected many, but a line had to be drawn as to how much BP reasonably needed to pay those affected since they could not possibly pay each entity what it asked for. It was educational to see just how many factors go into determining what a fair estimation of litigation fees is. The topic of contingent liabilities is not something that can be easily grasped in a typical financial accounting class and this case allowed me to apply the concepts that were only abstract to me previously. Another takeaway from this case was how to balance conservatism with reasonableness to ensure the entity is being frugal without overpaying.

a. What is a contingent liability? Explain, in your own words, when a company would record a contingent liability on its books. List some types of contingent liabilities. Do companies ever record contingent assets?

A contingent liability is a future obligation that is probable to occur. To meet the criteria of a contingent liability the obligation must be probable, and the amount must be reasonably estimable. If both criteria are not met, the contingent liability is reported in the footnotes of the financial statements, not on the actual balance sheet. Although it is not certain that these liabilities will be incurred, they must still be presented on the company’s balance sheet as they typically significantly affect a company’s financial position. Some examples of contingent liabilities include litigation fees and warranty expenses. Pending lawsuits typically negatively affect a company more than warranty expenses because they occur less frequently, and their effects tend to be higher. Warranty expenses are more operational than lawsuits and companies have an allowable, estimated number of expenses to be incurred in the future pertaining to warranty expenses whereas for litigation fees they do not.

Companies can also have contingent assets. Contingent assets are recorded in the notes of the financial statements, not on the actual balance sheet. GAAP is based on the principle of conservatism, and to be fully conservative, a company must not record gains until actually recognized. This presentation more accurately represents a company’s current financial position.

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

From BP's perspective, the product warranty means that in the event of a product defect within two years of the purchase, GE will replace or repair the telescopic joint for BP at no additional cost. This could qualify as a contingent gain for BP, however; the amount, timing, and probability of occurrence are all unknown. Even so, BP should still include the warranty in the notes section of the financial statements to let its users know which of their assets are insured under warranty.

From GE's perspective, the product warranty means that in the event of a product defect within two years of the sale, they will replace or repair the telescopic joint. The cost of this repair is included in the price of the joint and GE will report this as a contingent liability. This money is allocated to replacing and repairing the joint if these expenses are incurred. This expense is currently estimable, and probable based on past years' results. As they do not expect for their products to have defects, it inevitably happens, so this contingent liability would be presented on GE's balance sheet.

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

Management needs to estimate the amount of contingent liabilities. To estimate accrued warranty costs management must base their judgement on previous years' results and adjust them each year based on previous sales and current volume of sales. They should also be conservative with these estimates as it is always better to overestimate the amount of liabilities than underestimate them. The higher the number of sales, the higher the probability that there will be defects and therefore an increase in warranty claims. It is nearly impossible to estimate the timing of each claim, but they can reasonably estimate the amount of contingent warranty liability each year. A company may strive for higher quality products to reduce its amount of accrued warranty costs.

Claims for damages after the oil spill are treated differently than a warranty claim. Claims for damages are unforeseen liabilities and are not estimated before their occurrence. In the case of damages, there is no allowance account to cover the costs and they tend to be much larger than any warranty liability. Damages result from a lawsuit, so there are many added attorney and legal fees in addition to the possibility of a contingent liability for the damages caused directly and indirectly with the faulty product or damages caused by the company. In BP's case, their damages were caused by defective equipment and not the sale of a faulty product.

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

The BP oil spill was detrimental to the environment of the United States Gulf Coast and negatively affected every industry in some way. Some of the entities that could have sued BP for direct damages include commercial fishermen, charter boat companies, hotels, rental property owners, wildlife centers, and local business owners. All of these entities rely heavily on tourism and the environment to steadily grow. Because of the oil spill, there was a steep decline in tourism which is a main driver of the economy on the Gulf Coast. Another group of people that sued for damages were people that experienced health issues due to the toxicity of the oil in the water. These entities all sued BP rightfully as they all experienced negative effects from the oil spill first hand.

Conversely, BP did not deserve to take all of the blame. There were two other companies that were highly involved in the oil spill that did not take any of the fall. BP leased the oil rig from a company called Transocean and that rig was partially operated by another company called Halliburton. Although these entities were not as much to blame as BP, they still should have shared in a portion of the damages seeing they were both materially involved in the spill.

As there were several entities that could have and did sue BP after the oil spill, these damages also had to be reasonably estimated by BP. This estimation was difficult because the spill happened shortly after the 2008 recession and businesses were already in financially pressed situations. Many entities sued BP for more than the necessary amount because the oil spill emphasized the negative effects of the recession. From the perspective of an auditor, one would need to be careful about not overestimating damages payable for lost business that is due to the recession and not solely the oil spill. To do this, the auditors should take actual results from the previous months of 2010 and use those as an estimate of what would have happened in the remainder of the year. Any profits less than this prediction can be attributable to the oil spill.

In 2010, BP set up a $20 million escrow account to go toward damages from the oil spill. This amount was estimated based off of lost profits of the major affected industries including fishing, boating and tourism. However, BP does estimate that they will be liable to pay more than this amount in the future. Since it can be estimated that BP will have to pay more than $20 billion in the future, this contingent liability should be larger on the balance sheet. As previously stated, GAAP requires conservatism on financial statements and to be fully conservative BP should account for the worst-case scenario to properly show its current financial position. However, BP's management also has to be careful not to settle and pay more than the necessary amount.

The oil spill itself could not have been prevented, but the information given to the public about the severity of the spill could have. BP severely underestimated the gallons of oil that were spilling into The Gulf daily. Because of this, they were able to be sued for much more money. They could have settled for smaller damages payable if they would have been completely truthful about the severity of the issue. They also could have taken more safety precautions like having more regular, thorough inspections of all of their equipment to make sure it is completely safe. Given these facts, some believe that BP was grossly negligent. However, this was not ultimately proven because the notes to the financial statements say that the situation did not occur because of gross negligence on BP's part.

Overall, the BP oil spill was detrimental to many and billions of dollars in damages should be paid to those affected. BP should estimate the amounts for those in the fishing, boating, and tourism industries first and then allocate a smaller amount for secondary damages that came about from the spill. These amounts should be presented on the balance sheet so that financial statement users can better fully understand their current financial position.

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Case #9 - Wendy's

Purpose

This case focused on the topic of accounting for equity investments using the equity method. The equity method is used when the investing company, or investor, invests enough money to have a controlling interest in the parent company, or investee. To have controlling interest, the investor must own enough equity such that it can exert significant influence over the parent company. Significant influence varies by situation, but generally occurs when the investor owns between twenty percent and fifty percent of the investee's equity. The equity method is fairly simple to account for in general journal entries but can get complicated in the financial statement presentation of the investor as the relevant numbers are sometimes buried unclearly in the statements and notes. This case allowed students to use their knowledge of accounting thus far to think critically identify certain numbers on the financial statements and identify how they were calculated.

Takeaway

My main takeaway from this case was that financial statements presentation is not as straightforward as I previously thought. With my experiences in financial accounting to date, every amount has been clearly labeled and placed on the appropriate financial statement. However, this case taught me that large companies have much more complicated amounts to report and they must consolidate certain areas, or the financial statements would be incredibly too long and inefficient. I learned from this case that all amounts necessary to evaluate a company are reported on the financial statements, however; there is some intuition required to discover certain amounts.

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

There are many reasons why a company might want to enter into a joint-venture agreement. One reason is to grow their customer base. Even if the companies in the joint-venture are in the same industry, they will not have the same customers and will inevitably have more customers collectively than they would separately. This gives joint-ventures a competitive advantage over other companies in the industry since they have a broader customer base over a larger geographical range.

Financially, there are many reasons to enter into a joint-venture. The companies can minimize costs as well as risk since there are more resources to allocate them to. Joint-ventures allow companies to create economies of scale and synergies to form an efficient and effective business. The main financial reason for creating joint-ventures, however; is the major tax benefits they receive.

Lastly, companies can also share technological resources. Since technology gives companies the most competitive edge in today's tech-driven world, the combination of innovative technologies gives a joint-venture a competitive advantage. Each company can use past experiences to create new or improve upon existing technology for the most advanced and innovative business possible.

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

To use the equity method, the purchasing company, or investor, must acquire enough ownership in another company, the investee, to exert significant influence or have a controlling interest in the company. Typically, an investor must own between twenty and fifty percent of the investee to exert significant influence, depending on the situation. When the investor does exert significant influence in the investee, they must account for the investment differently than an equity investment where they do not exert significant influence. The initial purchase of the equity investment is the same no matter what method is used, but the changes in value are accounted for differently depending on influence. With equity method investments, their fair value is not adjusted by market value, rather the outcome for the year of the investee. The investor must share in the profits and losses of the investee when valuing the investment. When the investee has net income or loss, the investor will share in that net income or loss to the extent of the percentage of equity they own in the other company. For example, if company A invests in company B such that it has a fifty percent interest in company B, then company A would have significant influence in company B. Company A would record the initial investment at historical cost. If company B has net income of $1 million then company A would report an increase of five hundred thousand in its investments account. The same would be true with a net loss situation except the investment account would decrease. When company B declares dividends, the investment account of company A would decrease, but company A would also receive cash for the dividends. The payment of dividends by the investee causes the investor's equity investment total to decrease, but it increases cash on the statement of cash flows.

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

Since the investing company paid more for equity in the company than its market value per share, the excess is called the acquisition accounting premium. The acquisition accounting premium has two separate parts. The first involves writing up the fair value of the net assets and the second is goodwill. First, the investing company must take the excess of the purchase price and allocate it to the assets and liabilities such that their value reflects the fair market value at the time of purchase, not the historical cost of the originating company. The rest of the acquisition accounting premium goes into the goodwill account. Goodwill is an intangible asset that arises from the sale of a portion of a company in excess of its fair market value. Goodwill is not amortized, so the amount in the account will stay constant unless a portion of the company is sold again or if it becomes impaired. Companies should test goodwill every year for impairment and take the necessary actions to adjust its fair value if it is found to be impaired.

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

In 2012 and 2011, Wendy's included $89,370 thousand and $91,742 thousand respectively for its investment in TimWen. These amounts appear on Wendy's balance sheet under the Investments section, however; there are multiple numbers that go into the amount presented on the balance sheet. These numbers are broken down further in Note 8. Other amounts included in the investments line of the consolidated balance sheet include equity investments in a joint-venture with Japan, and other cost investments. The final amount for the total investment in TimWen for 2012 and 2011 consists of earnings, amortization of purchase price adjustments, dividends received, and foreign currency adjustments.

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

The total equity of TimWen in 2012 is $70,565 thousand and Wendy's has a fifty percent interest in the joint-venture, so Wendy's share of this equity is $35,283 thousand. Since Wendy's reports $89,370 thousand of total equity investments in TimWen, the difference in these two numbers is $54,088 thousand. This difference is due to purchase price adjustments. Wendy's paid more than the market value for its investments in TimWen, so the difference here is the write up of net assets and the increase goodwill as previously explained in part (c).

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

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

Since Wendy's paid more for equity in TimWen than its price per share, there is an excess as previously discussed. This excess must be amortized, which decreases the value of the investment. The total equity earnings for the period in 2012 and 2011 were $13,680 thousand and $13,505 thousand, respectively, but after amortization the total earnings before taxes came to be $10,551 thousand and $10,571 thousand for 2012 and 2011, respectively. This appears under "other operating expenses, net" on the consolidated statement of operations.

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

Equity Investments	13,680	
Equity Income		13,680

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

Equity Income	3,129	
Equity Investments		3,129

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

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

Cash	15,274	
Equity Investments		15,274

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

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

This amount comes from the earnings before tax of $10,551 thousand from the investment in TimWen and the loss of $1,827 thousand from the investment in the joint-venture with Japan. Since earnings from equity investments are noncash and positive, this is treated like a gain on the statement of cash flows and is deducted from net income.

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

Since Wendy's uses the equity method in accounting for its investment in TimWen, it records a decrease in value of the investment account when dividends are distributed. However, Wendy's still receives cash from the payment of dividends, which increases net income. The calculation of these distributions is shown in Note 8 under "distributions received" from the TimWen joint-venture.

Case #10 - Johnson & Johnson

Purpose

The purpose of this case was to further students' understanding of pension obligations. Pensions are a complex subject matter and require a great deal of exposure to be able to fully grasp conceptually. For many companies, pensions are likely the largest outstanding liability, so they have to be accounted for differently than most other long-term liabilities. This case took students step-by-step through each element of pensions starting with defining the basic components of pensions and then eventually allowed students to apply those concepts to reveal where each pension related amount is accounted for on the financial statements. While completing this case, students were required to think critically about each step in the funding process and what they mean for all the related accounts.

Takeaway

After completing this case, I feel that I have a stronger grasp on pensions than I did when I began. I had little understanding of pensions and I was able to build on that knowledge greatly by thinking critically regarding each element of the pension obligation. First, I was able to understand the types of benefit plans as well as differences between types of pension plans. Next, I was able to grasp each component of the retirement obligation conceptually by defining them. Then, I was able to apply these concepts by understanding where they fit in the funding process of pension obligations. I was able to fully grasp why pensions are accounted for differently than other long-term liabilities and I was able to see the flow of amounts through each step of the pension funding process. I am now able to clearly understand each element of pension obligations and where they appear on the financial statements of the company.

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

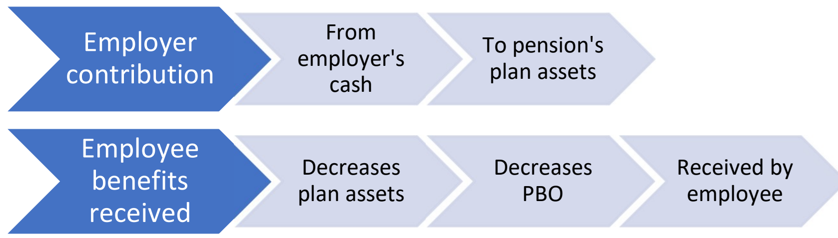
i. How do these plans differ? Which type does Johnson & Johnson have?

A defined benefit plan is when the employer contributes to the retirement fund and the employee is promised a set amount of money when they retire. All of the risk is borne by the employer in a defined benefit plan. Conversely, a defined contribution plan is when the employee contributes to the plan and the employer matches those payments. In a defined contribution plan, the employee bears the ultimate risk which is why defined contribution plans are more common. Johnson & Johnson has both of these plans in place, however the majority of their plans are defined benefit.

ii. Explain why retirement plan obligations are liabilities.

Retirement plan obligations represent a future amount to be paid to employees in compensation for their current work. Any future obligation is considered a liability and retirement plans fit that criteria. The only difference in retirement plan obligations is the way they are accounted for on the financial statements.

Figure 10-1



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

To record a retirement plan obligation, many assumptions must be made, as it is far from a straightforward calculation. Some of the assumptions necessary are the estimated remaining service life of employees, mortality rates, salary changes, and time value of money. The calculation of the effects of these assumptions are quite complex and should be left to an actuary, not the management of the company.

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

Service cost is the current expense incurred by employees for their services that increases the pension obligation for the year. The interest cost is based on the projected benefit obligation. The projected benefit obligation is a deferred liability, so it is recorded at a discounted amount. The rate in which interest is based on is called the settlement rate, which is determined by an actuary. This settlement rate is the amount of the projected benefit obligation that the company will have to pay interest on for the year because of time value of money factors. Actuarial gains and losses are the changes in the projected benefit obligation that are different from the initial actuarial predictions that are based on service years, mortality rates and changes in salary. Benefits paid to retirees are the actual benefits that the employees received for the year. The benefits reduce both the projected benefit obligation and the pension assets.

c. **In general, company's pension assets are influenced each year by three main types of activities: actual return on pension investments, company contributions to the plan, and benefits paid to retirees.**

Return on pension assets arises from the return on the current amounts in the pension plan that are invested by an outside investment group so that they will grow over time. Each year the return is estimated based on market changes, but it is difficult to predict the return exactly, so there is typically an adjustment to the actual return on plan assets account. The return each year is based on dividend and interest payments received by the company. The pension assets are also influenced by the amount in which the company contributes to it each year. Contributions come straight from the cash of the company and increase the pension assets so that they can grow and earn a greater return. Benefits paid to retirees come straight from the pension assets, not the company's cash. The benefits paid reduce the amount of pension assets and also decrease the projected benefit obligation.

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

Pension expense uses the expected return to reduce volatility caused by the market in the income statement. If there is a return during the period, this means that the company's pension expense will be lower, and the amount funded in the plan assets will be higher.

The actual return on plan assets that goes into pension expense is a net of actual return and expected return on plan assets while the full actual return goes into the plan assets account. The residual of actual versus expected return on plan assets goes into an account titled “Other Comprehensive Income-Gains and Losses”.

e. **Johnson & Johnson provides other benefits to retirees including health-care and insurance benefits. What is the primary difference between the company’s other-benefits plans and its retirement plans.**

Retirement plans are a substantial liability to companies that have their own separate fund to ensure that appropriate benefits can be paid to employees. The terms are contractual and strict. However, health-care and insurance benefits are not nearly as large of a liability and their terms are lenient compared to those of a retirement plan. These benefits do also have a separate account for benefits to be paid to employees, but they are not nearly as complex.

f. **Consider Johnson & Johnson’s pension expense detailed on page 61 of the company’s annual report. Note that the company uses the term “net periodic benefit cost” to refer to pension expense.**

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

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

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

Pension Expense	1,253

Projected Benefit Obligation	1,253

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

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

The value of the retirement plan obligation at December 31, 2007 is $12,002 million. This value represents the amount that is owed to employees in benefits as they retire. This number is mostly reliable as it is a good faith representation of what Johnson & Johnson believes it owes its employees based on actuarial assumptions. However, it is highly unlikely that this is the exact number they will actually pay to employees in the future.

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

The pension related interest cost for the year is $656 million. The beginning PBO is $11,660 million and PSC amendments are $14 million. This would mean that the interest rate used by Johnson & Johnson for the year was five-point six percent. This is determined by dividing the current interest cost by the projected benefit obligation at the beginning of 2007.

Reasonable interest rates depend on the current market conditions as well as the types of investments involved. However, this falls within the domestic and international rates disclosed in the footnotes. This interest cost was computed right before the recession of 2008, so it is likely this interest rate was vastly different in the year following, which would make it difficult to compare interest costs across years.

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

During 2007, Johnson & Johnson paid $481 million to retirees. Johnson & Johnson did not pay cash for these benefits directly. Each year, Johnson & Johnson contributes cash to the fund, or plan assets. The assets are then invested so they will grow and earn a return. When benefits are actually paid, they come out of the plan assets, not the cash of the company. The benefits paid reduce both the retirement plan obligation and the retirement plan assets as there is now a smaller amount owed to employees and the plan is less funded since the benefits came directly from it.

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

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

The value at December 31, 2007 of the retirement plan assets is $10,469 million. This is the value of all of the contributions and return on investments in the fund that are currently available to be paid to employees as retirement benefits.

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

In 2006, the expected return on plan assets was $701 million and the actual return on plan assets was $966 million. In 2007, the expected return on plan assets was $809 million and the actual return on plan assets was $743 million. In 2006, there was a difference of about 38 percent and in 2007 there was a difference of about negative eight percent. In my opinion, both of these differences are significant, especially the difference in 2006. To be insignificant, I believe that the difference should be closer to five percent. Based on this, the difference in 2007 is not extremely significant, however; the difference in 2006 is major. These differences prove that the actual return on plan assets much more accurately portrays the company's economic position. In 2006, there was a difference of $265 million, which is almost three percent of the company's net earnings for that year. At the beginning of the year, these amounts can be estimated, but they should be adjusted periodically throughout the year to accurately portray the company's position.

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

During 2007, Johnson & Johnson contributed $317 million while their employees contributed $62 million. During 2006, Johnson & Johnson contributed $259 million and their employees contributed $47 million. The company contributed more in 2007 than it did in 2006 and will continue to increase payments yearly as shown on page 63. In the notes of the financials, Johnson & Johnson states that it did not meet the minimum statutory funding requirement for funding in 2007 and does not anticipate it will meet this minimum in the coming years.

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

The U.S. plan assets consist of debt and equity securities, while the international plans consist of debt and equity securities along with real estate and other assets. Both the U.S. and international plans primarily consist of equity securities.

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

At December 31, 2007, the company's retirement plan is underfunded by $1,533 million and is underfunded by $2,122 million in 2006. These amounts appear on the balance sheet under employee-related obligations. This can be inferred since the current retirement obligation status is underfunded, so it appears as a long-term liability on the balance sheet.

Case #11 - Balance Sheet Versus Income Statement Approaches

Purpose

The purpose of this case was to allow students to think critically about the current accounting practices and make conclusions about their effectiveness. In this case, students were to read “On the Balance Sheet-Based Model of Financial Reporting” by Ilia Dichev. This article is based on the opinion of the author and discussed the shortcomings of the current basis of accounting, the balance sheet approach. The article discussed the main reasons why the balance sheet approach is deficient and why the income statement approach is ultimately superior. After giving her opinion, the author then presented a potential solution. She concluded that the income statement method should be required with a few fundamental changes. Students had to take the information presented, critically evaluate it, and then apply it to their future careers.

Takeaway

This case was very beneficial to me in that it made me challenge the way I currently think. I too often find myself accepting information exactly how it is presented to me without considering reasoning behind it. I previously thought there was only one way to account for most things, and it wasn’t until I completed this case that I learned that is false. Accounting is a much more subjective matter than I previously thought, and I now know that standards and methodologies can be changed over time. This case will allow me to critically think in my future career and see if there could be a more effective or efficient way to do things, even if it does not directly relate to accounting principles, but any information I receive. I will now be more willing to dig deeper into subject matter and consider alternative solutions to create the most ideal outcomes.

a. Read and summarize the CPA Journal article.

This article was centered around the current shortcomings of FASB's approach to accounting. The main focus was the difference between the income statement and balance sheet approaches. Currently, FASB requires the balance sheet approach because they feel it is conceptually stronger to value assets and liabilities to determine the value of a company. The balance sheet approach focuses on valuation of assets and liabilities to determine a company's value, whereas the income statement approach measures the change in value of a company through revenues and expenses. FASB currently feels that it is difficult to measure these changes in value over time without a firm basis of what first creates that value, which relies on assets and liabilities. The balance sheet approach is currently required by the IASB as well, making it globally used.

Although the FASB currently requires the balance sheet approach, the author of the article suggests that the income statement approach is superior, and FASB should consider moving to that approach. The author presents four main themes to argue for the income statement approach and against the balance sheet approach. The author says that the balance sheet is contradictory to the way businesses operate and are managed, the conceptual strength of the balance sheet approach is unclear in relation to the income statement approach, the balance sheet approach is causing a decline in the future usefulness of earnings, and that there are problems with applying the balance sheet method in practice. After the author detailed why the balance sheet method is inferior, she gave a potential solution for what FASB should do to correct the shortcomings of the current reporting standards. The author believes that there should be a clearer distinction between operating and financing activities and that there should be a larger emphasis on the matching principle and less emphasis on the revenue recognition principle. As far as distinguishing between operating and financing activities, earnings relating to operations have stronger predictive power and more clearly portray the actual earnings for the current period whereas earnings from financing activities reflect market fluctuations and do not give much insight to the income of the company for the period and provide little aid for predicting future earnings.

The current FASB requirements focus heavily on the revenue recognition principle to make certain that revenues are recorded properly. However, the matching principle is not as straightforward and leaves room for interpretation in the current requirements. The author believes that revenues should be more clearly matched with expenses so that the actual firm position is better shown. The article gives the example that current expenses should be capitalized and expensed over the period benefitted by the purchase instead of taking the whole expense when purchased and experiencing gradual benefit over time.

The author realizes that it is a daunting task for FASB to change from the balance sheet to income statement method and that the changes suggested will not happen anytime soon. The main purpose of this article was to raise awareness of the current shortcomings of financial reporting and to make some suggestions on how to improve upon it.

b. How did reading this article change your current way of thinking?

Prior to reading this article, I never considered the logic behind the way that financial reporting is done. I accepted the idea that assets and liabilities govern the way a company is valued since that is what I have been taught in school. After reading this article, I understand the shortcomings of the current reporting system and I have been able to critically think about and explore new ways that a company's financial position can be better reported for its users.

I think that both approaches have valid points, but I do not believe that either method is perfect. I agree with the balance sheet approach in that assets and liabilities are the building blocks of firm value and earnings cannot be determined without considering them heavily. However, I do not think there is currently enough emphasis on income and where it stems from. The author of the article made the observation that operating, and financing activities need to be more clearly distinguished as they both give insight into completely different information. Operating activities provide information relevant to the current period's performance and can help predict what future years' outcomes will be. Financing activities provide value to firms, but do not help predict future earnings and are not as relevant to users of financial statements in relation to current period performance. Distinguishing between these would considerably help the relevance of financial reporting under the balance sheet method and the income statement method.

As far as the income statement approach, I believe that it is conceptually stronger and does a better job of reporting current period performance. It is focused on changes in value of a company and I believe that is more useful to financial statement users while also strengthening comparability across years. However, I do agree with the author in that it would be a much stronger method if it emphasized the matching principle. If there were clearer requirements for matching that encouraged companies to match the benefits with the obligations, then companies' financial positions would be more accurate. Instead of expensing investments fully at their inception, these expenses should be capitalized over the life of the asset so that the benefits and the obligations match.

After analyzing both methods, it can be concluded that both have their strengths and shortfalls which makes it difficult to decide one which one should be the accepted practice. The balance sheet approach seems to be more appropriate in industries where debt and assets drive the company and the income statement approach is more appropriate for service type industries. My initial thought is to make the overall changes suggested by the author, but to also allow different approaches for different industries. More confusion than necessary could arise, and comparability would be severely reduced, but the overall quality of financial statements would be improved. However, since creating and implementing a new accounting method is extremely difficult with an extensive timeline, I am unsure that the benefits of this would outweigh the costs. Because of that, I believe that the best solution is to move toward the income statement method with a few amendments. Since management uses the fundamentals of the income statement to budget and drive everyday operations, this method is more reasonable in my opinion. Revenues and expenses drive business and assets and liabilities are secondary measures of current earnings. Plant assets and bonds payable do impact companies significantly and should not be overlooked, however; they do not give much insight to financial statement users on the current or future performance of a company.

This analysis is the first time I have ever needed to think critically and evaluate an accounting principle. Previously, I took principles at face value and never considered that they may not be the most effective way of accounting. Reading through this article has helped me to see that accounting methods are not necessarily concrete and that there could be more effective or efficient ways to account for things. I will now question the effectiveness of the information presented to me in my classes and I will consider the costs and benefits of alternate treatment.

c. How will you use this information in your future career? Be thoughtful and creative about the situations you will encounter where this article will affect your beliefs and the way you carry out your future job.

For me, there were two major takeaways from reading and analyzing the article presented. The first takeaway is more in-depth knowledge of the balance sheet versus the income statement methods of accounting and the second is the thought process of questioning information presented to me and analyzing it for effectiveness. Both of these will be applicable to me in my future career.

As far as the actual content of the article, I will definitely use my knowledge of the balance sheet versus the income statement methods. I hope to eventually be a manager at an accounting firm and in that position, I will use the income statement approach quite often as budgeting always starts with predicted revenues. However, when actually auditing financial statements, the balance sheet method will be used since it is what FASB currently requires. I now am able to make key distinctions between the two and I understand the importance of both approaches. The balance sheet approach is a more long-term approach that keeps in mind previous performance whereas the income statement approach focuses mainly on the current period. When budgeting for my own company, I will focus on the current period, but when making key decisions on what to do with the profit generated in the current year it is important to think of profits related to the balance sheet.

In completing this case, I learned that the current accepted practices of accounting are not necessarily the only way to do things. I had never thought about there being multiple correct ways to account for a certain situation and I definitely never thought that I might be able to think through multiple options and choose the most effective one. I believe these critical thinking skills will go hand in hand with innovation surrounding data analytics. Data analytics will allow us to be more productive and efficient, making it possible to bring new ideas to life. For example, it used to be common practice to sample data to attest to the accuracy of financial statements during an audit. Now it is possible to test an entire data set for errors, making financial reporting much more accurate. Many new ideas will be able to come to life because of data analytics tools. However, to be able to apply data analytics, it is necessary for someone to have an innovative idea on how to amend a current practice and that is a skill I now have.

Case #12 - Google

Purpose

The overall topics of this case were non-GAAP financial reporting and the effects of earnings on stock price. Since one of the main principles of GAAP financial reporting is conservatism, it is required that every change in financial position be reported. However, many companies do not believe that nonrecurring expenses should be reported in earnings as they do not represent the actual performance for the year. Some examples of expenses or losses that reduce comparability between periods are losses from discontinued operations and expenses from stock-based compensation along their individual tax effects. Non-GAAP numbers are what management uses to make decisions and they tend to be a better predictor of future earnings. For this case, students had to first be familiar with the concepts surrounding GAAP versus non-GAAP earnings and then apply that knowledge and form opinions surrounding Google's treatment of non-GAAP earnings and their appropriateness.

The second main part of the case was the relationship between stock price and earnings. Typically, earnings and stock price have a positive correlation with each other as well as the market trends. However, this case showed that there are often times other factors that affect these outcomes. In the fourth quarter of 2013, Google did not meet its earnings per share projections but still experienced a major growth in stock price. This was partially due to a positive press release and a favorable article published by the *Wall Street Journal* that covered all of the positive factors that Google was experiencing and only briefly mentioned the unfavorable outcomes.

Takeaway

I found this case very beneficial for several reasons. I had previously only heard of non-GAAP financial measures and I did not know why or how they were used for reporting. I am now knowledgeable about the reasoning behind the reporting of these measures along with the protocol necessary to report non-GAAP measures on official financial statements. I also understand why they companies find it beneficial to report these amounts, but I also still see the need for actual GAAP earnings to be reported along with a reconciliation between the two. It is logical that non-GAAP earnings are more comparable between periods and it also makes sense as to why companies want to include them to make their financial performance seem enhanced. My ability to analyze and understand these amounts will be very helpful in my future career when I am auditing public companies.

While completing this case, I also learned about the importance of press releases and news articles on stock prices. As shown in this case, stock price is not solely based on earnings or market trends. Google did not meet earnings projections in 2013, yet still experienced significant increases in stock prices. This allowed me to think critically about the way information is reported and to more deeply understand how the media can have an impact on external users' investments in companies.

a. **Read the excerpts of the press release titled "Google Announces Fourth Quarter and Fiscal Year 2013 Results" and review Google's operating performance reported in the statements of income accompanying the press release. The press release includes information about non-GAAP financial measures for the fourth quarter of 2013. Consider the table that reconciles GAAP measures to the non-GAAP measure. What explains the difference between GAAP net income and the non-GAAP equivalent? Do you agree with each of Google's adjustments in computing non-GAAP earnings? Why or why not?**

Google presents GAAP and non-GAAP measures for operating income and net income along with a reconciliation of one to the other. Google believes that its non-GAAP measures are "superior" to GAAP measures because they provide more of an insight into liquidity and current operating performance by excluding nonrecurring expenses. Google presented these numbers along with the reconciliation and description of why they included each amount, which is required if a company would like to present both. The reconciliation of GAAP to non-GAAP shows that Google eliminated stock-based compensation expense, restructuring and related charges, income tax effects related to the stock-based compensation and restructuring charges, and a loss from discontinued operations.

I believe that Google made the correct decision in eliminating these expenses for their non-GAAP income, except for stock-based compensation. Stock-based compensation is part of the way Google pays its employees, therefore it is a recurring, operating expense. It is often excluded because it is not a part of salaries and wage expense, but it should not necessarily be excluded since it is a recurring expense to compensate employees for work done. The other expenses, however; are correctly eliminated. Although these expenses need to be reported as they had a material impact on the financial position of the company in 2013, they do hinder the presentation of actual earnings. Google had impressive outcomes for 2013 that were slightly offset by their nonrecurring expenses and respective tax effects. A loss from discontinued operations does not provide any insight to the liquidity of the company and is not necessarily relevant in decision making for internal or external users. Google believes that they are providing greater transparency and helping their financial analysts by eliminating those expenses in their non-GAAP financials. I think that by eliminating these expenses, Google is increasing comparability across periods to allow for a more in-depth analysis of performance over time.

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

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

From 2012 to 2013, Google's net income increased by $2,183 million. This growth is significant and their stock prices during 2013 reflect this growth. Google's stock price per share increased steadily over 2013, growing almost five hundred dollars per share. The stock price increased after every quarterly earnings release, with the exception of quarter two which fairly stayed constant.

ii. **Compare Google's 2013 stock price performance with the performance of the broader stock set of firms trending on the NASDAQ exchange (that is, the NASDAQ index).**

Google's cumulative stock return grew at fairly similar rates as the NASDAQ exchange during the first three quarters of 2013. However, during the fourth quarter of 2013 and the first quarter of 2014, Google experienced extreme growth and surpassed the return of the NASDAQ by about an average of fifteen percent. This shows that Google's high performance at the end of 2013 was not only due to favorable market conditions, but other outside reasons pertaining to growth of the business.

iii. **Based on the stock market chart, did the market perceive the earnings news in Google's press release dated January 14, 2014, as "good news" or "bad news"?** ***Note: the press release was made available after the close of trading for the day.***

The market perceived the earnings in the January report as good news. From January to February, Google proceeded to experience increased growth even after the rest of the market faced a small decline.

c. **Read the *Wall Street Journal* article from January 30, 2014 titled "Google Reports Higher Profit".**

i. **According to the article, how did Google's fourth quarter revenue and earnings compare to the consensus analyst forecasts at the time of the earnings press release?**

Analysts predicted that Google would finish the year at $12.20 per share, but they finished the year at $12.01 per share. However, this did not negatively affect Google's stock price per share as it still experienced growth.

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

Investors in Google seem to be less worried about the below predicted earnings per share and more focused on the overall positive growth the company is experiencing. Some factors that are showing positive growth for the future include Google's shift to mobile devices, product ad listings, and app sales on the Google Play store. Investors are also glad that Google sold off Motorola to Lenovo to get rid of "potential distractions" from Android phones. Google is also focusing on improving its data centers so that search results can continue to be quicker. Other positive factors include an increasing cash balance as well as several new employees.

Some factors that may be worrisome for investors are the decreases in per-click revenue resulting from shifts to mobile devices. Google receives less revenue from clicks on mobile devices than it does on non-mobile devices, so they are seeing a decrease in revenue from this category because of increasing amounts of mobile device users. However, Google is adapting to the shift to mobile devices by improving search results, being innovative with online shopping and improving its app store, Google Play. Although they are being proactive in this shift, there is still future uncertainty since they do not get as much revenue from mobile clicks as from traditional browsing sources.

Even though Google did not meet all of its predicted earnings, the company still got positive press and was able to experience growth partially because of this positive press. This shows the power of the media and the effect it can have on investors' decisions.