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An Exploration of Financial and Accounting Principles and Methods

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AN EXPLORATION OF FINANCIAL AND ACCOUNTING PRINCIPLES AND METHODS

by
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ABSTRACT

STEPHANIE GREEN: An Exploration of Financial and Accounting Principles and Methods

(Under the direction of Dr. Victoria Dickinson)

This collection of case studies and text is a culmination of the twelve case studies assigned by Dr. Victoria Dickinson over the course of the Professional Research and Development Research Program. This program that is unique to Sally McDonnell Barksdale Honors College accounting students at the University of Mississippi, and it encourages the student to engage with the topic matter of accounting, taking a holistic view of what they are simultaneously learning in other courses. Each case examined a different issue or accounting method that ultimately expanded students' knowledge and better prepared them for their future careers. The case study process promoted self- discovery while also utilizing teamwork and group collaboration, better preparing students for the future, especially in public accounting. Overall, these case studies expanded students' accounting breadth and better prepared them for their future in the accounting world.

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Case Study #1: Google Fusion

Case Study #1: Data Analytics- Google Fusion

Case Description:

This case study is about database management tools, and how they could be useful in audit and tax planning. The particular tool that I have been looking at in great detail is Google Fusion. Google Fusion is a data analytics tool that offers many benefits to the work place. It allows multiple people to analyze and add data to the same worksheet simultaneously, which can help to make the workplace more efficient. Google Fusion also allows numerical data to be mapped, so it can show hot spots in purchases or sales, or how numbers compare within a region. Google Fusion is still being fully developed, but the opportunities to benefit from it are numerous. This case study will also be beneficial to the future because many accounting firms are moving to some sorts of data management and analytic tools, so knowing the benefits of these will be very beneficial to my future employment.

This case taught me a lot about data analytics tools and Google Fusion in particular. I was previously unaware of how large a role data analytics played in the audit and tax roles of public accounting, but through this case study I have seen their growing role and the large benefit of using them will provide to be able to analyze large quantities of data quickly, instead of just spot sampling data and numbers. The accounting industry is moving more toward data analytics rather than just repetitive computations, so this case is very helpful in learning more about a data analytics tool, what they offer, and how they can realistically be used within the public accounting sector.

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

Google Fusion is a newer and experimental application from google, focused on collaborative data sharing and making data visually understandable. In google fusion, multiple people are able to collaborate within the same google fusion document at the same time. It also gives people the ability to upload different types of data (i.e. Microsoft Excel, google sheets, etc.) onto google fusion, to keep working on it without worrying about having to make sure the data are all in the same format or completed in the same application. Google Fusion is used within businesses to make large amounts of data more understandable through visualization tools, especially the geocoding and mapping software. It is also used in business because of its ability to have multiple people collaborate on the same table simultaneously, as well as the ease of uploading data from different sources.

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

Audit

For auditing purposes this tool could have many uses. One use could be with its real-time ability to turn entered data and use data from outside sources to make the data more visually understandable. To make a map, all a user has to do is enter the data into a table and from there it can be easily transformed into a map. The easy integration of a map into the audit process offers different opportunities for data to be geocoded, and for this example be turned into a heat map. The ease and seamlessness of data being turned into a heat map can make the audit process both more efficient and effective, as it would be easier to see inconsistencies within the data visually presented. For instances, if an auditor was working with a company that had an unusually high or low revenue during a period, it could bring attention that something may be wrong internally. The mapping feature of google fusion could easily and quickly display the data, while also incorporating real time data from outside sources, and through the mapping resources it could show an auditor that there was construction or road closures that prevented customers from doing business with said company. This would be of extreme benefit to an auditor because it could create efficiencies in doing the audit report, because they would not have to do extra research as the data visualization could help to make this data presentable and easy to see with the mapping feature showing that there were outside factors affecting their revenues during that period, rather than having to do extra research to figure it out.

Another way Google Fusion's mapping and data visualization could be beneficial to the auditing process is when looking for fraud and returns. An auditor could use the heat mapping functions to see if returns are uncharacteristically high at any locations. If returns are extremely high at a location that could be a sign of fraud occurring at a location, and that can sometimes be easily disguised through data, but when the data is turned into a heat map it would be easier to see if there are discrepancies and fraud occurring. Google Fusion could help to make the auditing process more efficient and effective through the data visualization tools.

Lastly, the ability to have multiple people work at the same time on the same data is a huge benefit. This could help in the audit business because you could have multiple people go through the larger amounts of data at the same time, catching each other's mistakes or just looking at different parts of their internal accounts at the same time to make the process more efficient.

Tax Planning

Google Fusion could make tax planning more effective and efficient as well. A goal of tax planning is to pay least amount of tax possible. Google Fusion could be a tool to help in this process because the collaborative features it offers could allow people to contribute directly from their location. This could be useful because you could train people to know the ins and outs of the tax planning process in their area, and because you have different people who are experts in their local area's taxes, they could do the process just in that part. But since it is collaborative, they could all work on the same company or enterprise, that way it could be more efficient, as many people could work simultaneously, and it would be people working who know that select region best.

Another way google fusion could be used is when expanding the business. When expanding business, it's important to see how the taxes will affect the future business as well as if it will be profitable enough, and which location makes the most sense. Using the data visualization tools available in google fusion you could look at the mass amounts of data already collected from a said business and see it more understandably in visual form and see where a new enterprise would be most successful, and if it is even possible or makes sense according to tax code. This could be especially beneficial if wanting to expand to a multinational enterprise because the tax laws become so different.

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

September 5, 2018

Dear Future Partners:

Our team should invest and acquire the google fusion tool. This tool could help to create more efficiencies within the business as well as become more effective within the accounting process. The google fusion data management has many tools and abilities that would make it beneficial to our opportunities. The data visualization tools, in particular the geocoding and mapping features, would be extremely beneficial in making the extremely large amounts of data understandable, and easier to recognize outliers and patterns within the audit world. The ability to same time collaboration features are also extremely beneficial to the company's overall efficiency, as it would enable multiple employees to work on the same data worksheet at the same time, rather than just one person working on it and then having to email it, and then that employee working on it and then emailing it back. It also enables data to be aggregated quickly which would also be beneficial to enterprises.

This tool would impact the staffing in different ways. While in concerns to staffing numbers, I do not believe this tool would make it necessary for the company to terminate employment, but instead this tool would necessitate job and role restructure. For tax purposes, this tool would enable tax accountants to work on the same data at the same time. This would eliminate their need to be up to date on tax code for big regions, and or different sectors. Instead they would be specialized in either a certain sector and or a specific geographic region. This would be a realistic opportunity because they would all simultaneously be able to look and add to the same data set, eliminating their need to know a broad range of information. In regard to audit accounting this tool would be an asset for auditors to use, but would most likely not affect the staffing required to run business.

Google Fusion would allow the company to comb through and analyze data more quickly, as well as allow and encourage collaboration. It's ability to handle different types and large quantities of data is also an asset, so I think by employing google fusion it would allow for the firm to take on more clients, and further positive relations with them. In terms of tax planning it helps to make a more efficient and quicker process, as it allows for collaboration. With audit, the google fusion tool allows an auditor to quickly aggregate large amounts of data, and has the capability to visualize the data immediately. By using these tools, an audit team could more quickly pour through data, as well as offer more future predictions as to what the data will be. Therefore, Google Fusion would allow for an audit team to take on larger clients, and clients with a broader spectrum of needs. Overall, I think our firm would greatly benefit from the services google fusion offers, and we should invest in this tool.

Case #2: Rocky Mountain Chocolate Factory

Case #2: Rocky Mountain Chocolate Factory

Case Description:

In this case we analyzed and completed financial documentation for the Rocky Mountain Chocolate Factory. We were provided the beginning and ending financial information, but had to post fifteen transactions from the company in between, as well as prepare a balance sheet and income statement. In this case I learned about posting transactions to an excel spreadsheet document, as well as making the correct postings for the fifteen intermediary transactions. At the end of this case study, we also had to analyze the transactions and accurately assign them to the correct heading of the cash flow statement. I also learned that there are certain transactions that have different options that could be correct if you post it to, so you have to pay attention to where the company wants certain resources allocated.

Part A.

I would expect to see many of the common balance sheet accounts like inventory, accounts payable, accounts receivable, cash, etc. I think cash, inventories, and PPE will constitute the major assets, while accounts payable, deferred incomes, and accrued expenses will constitute the major liabilities.

Part E.

Three adjustments or reclassifications that may need to be made are an inventory count, an adjustment to wages payable or another payable account, and then closing all the temporary accounts before preparing the income statement.

Journal:

		Beginning Balance (February 28, 2009)	1. Purchase Inventory	2. Incur Factory Wages	3. Sell Inventory for Cash and on Account	4. Pay for Inventory	5. Collect Recievables	6. incur SG&A (Cash and Payable)	7. Pay Wages	8. Receive Franchise Fee	9. Purchase PPE	10. Dividends Declared and Paid	11. All Other Transactions	Unadjusted Tri[al] Balance
Dr.	Cash and Cash Equivalents	$ 1,253,947			17,000,000	(8,200,000)	4,100,000	(2,000,000)	(6,423,789)	125,000	(498,832)	(2,403,458)	790,224	3,743,09
	Accounts Recievable	4,229,733			5,000,000		(4,100,000)						(702,207)	4,427,52
	Notes Recievable, current	0											91,059	91,05
	Inventories	4,064,611	7,500,000	6,000,000	(14,000,000)								(66,328)	3,498,28
	Deferred Income Taxes	369,197											92,052	461,24
	Other	224,378											(4,215)	220,16
	Property and Equipment, net	5,253,598									498,832		132,859	5,885,28
	Notes Recievable, less current portion	124,452											139,198	263,65
	Goodwill, net	1,046,944												1,046,94
	Intangible Assets, net	183,135											(73,110)	110,02
	Other	91,057											(3,007)	88,05
Cr.	Accounts Payable	1,074,643	7,500,000			(8,200,000)							503,189	877,83
	Accrued Salaries and Wages	423,789		6,000,000					(6,423,789)					[illegible]
	Other Accrued Expenses	531,941						3,300,000					(2,885,413)	946,52
	Dividend Payable	598,986										3,709	(1)	602,69
	Deferred Income	142,000								125,000			(46,062)	220,93
	Deferred Income Taxes	827,700											66,729	894,42
	Common Stock	179,696											1,112	180,80
	Additional Paid-In Capital	7,311,280											315,322	7,626,60
	Retained Earnings	5,751,017										(2,407,167)		3,343,85
	Sales	0			22,000,000								944,017	22,944,01
	Franchise and Royalty Fees	0											5,492,531	5,492,53
Dr.	Cost of Sales	0			14,000,000								693,786	14,693,78
	Franchise Costs	0											1,499,477	1,499,47
	Sales and Marketing	0						1,505,431						1,505,43
	General and Administrative	0						2,044,569					(261,622)	1,782,94
	Retail Operating	0						1,750,000						1,750,00
	Depreciation and Amortization	0												[illegible]
	Interest Income	0											(27,210)	(27,21
	Income Tax Expense	0											2,090,468	2,090,46

Journal (cont'd):

	12. Adjust for Inventory Count	13. Record Depreciation	14. Wage Accrual	15. Consultant's Report	Pre- Closing Trial Balance	16. Closing Entry	Post- Closing (Ending) Balance	Actual February 28, 2010 F/S Figures
Cash and Cash Equivalents					3,743,092		3,743,092	3,743,092
Accounts Recievable					4,427,526		4,427,526	4,427,526
Notes Recievable, current					91,059		91,059	91,059
Inventories	(216,836)				3,281,447		3,281,447	3,281,447
Deferred Income Taxes					461,249		461,249	461,249
Other					220,163		220,163	220,163
Property and Equipment, net		(698,580)			5,186,709		5,186,709	5,186,709
Notes Recievable, 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					88,050		88,050	88,050
Accounts Payable					877,832		877,832	877,832
Accrued Salaries and Wages			646,156		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	89,449
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	216,836				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			639,200		2,422,147	(2,422,147)	0	2,422,147
Retail Operating			6,956		1,756,956	(1,756,956)	0	1,756,956
Depreciation and Amortization		698,580			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

Income Statement

Rocky Mountain Chocolate Factory		
Income Statement		
For the Period Ending February 28, 2010		
Revenues:		
Sales	$ 22,944,017	
Franchise and Royalty Fees	5,492,531	
Total revenue		28,436,548
Cost and 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 Amortization	698,580	
total costs and expenses		$ (22,793,213)
Operating Income		$ 5,643,335
Other Income (Expense):		
Interest Income	27,210	
Other Income, net		$ 27,210
Income Before Income Taxes		$ 5,670,545
Income Tax Expense		$ (2,090,468)
Net Income		$ 3,580,077
Basic Earnings Per Common Share		0.60
Diluted EPS		0.58
Weighted Avg c/s Outstanding		6,012,717
Dilutive Effect of Employee Stock Options		197,521
Weighted Average Common Shares Outstanding, assuming Dilution		6,210,238

Balance Sheet

Rocky Mountain Chocolate Factory Balance Sheet As of February 28, 2010				
Assets:				
Current Assets:				
Cash and Cash Equivalents	$	3,743,092		
Accounts Recievable		4,427,526		
Notes Recievable, current		91,059		
Inventories		3,281,447		
Deferred Income Taxes		461,249		
Other		220,163		
Total Current Assets			$	12,224,536
other assets:				
Property and Equipment, net		5,186,709		
Notes Recievable, less current portion		263,650		
Goodwill, net		1,046,944		
Intangible Assets, net		110,025		
Other		88,050		
Total Long Term Assets			$	6,695,378
Total Assets			$	18,919,914
Liabilities and Owner's Equity:				
Liabilities:				
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	$	3,294,148.00		
Deferred Income Taxes		894,429		
Total Liabilities			$	4,188,577
Owner's Equity:				
Common Stock		180,808		
Additional Paid-In Capital		7,626,602		
Retained Earnings		6,923,927		
Total Owner's Equity			$	14,731,337
Total Liabilities and Owner's Equity			$	18,919,914

Cash Flows Designation (as pertaining to Journal Entry and Effect)

1. operating

2. operating

3. operating

4. operating

5.operating

6. operating

7. operating

8. operating

9. investing

10. financing

11. n/a

12. operating

13. n/a

14. operating

15. n/a

Case #3: Internship Scenarios

Case Study #3: Internship Scenarios

<u>Case Description</u>

This case was about students in the Patterson school of Accountancy and their internship process. There were 3 different scenarios modeled for us, and they were all conversations that have actually occurred or similar to situations people have gone through. It was very thought provoking and interesting. All three scenarios were things I hadn't really taken into consideration, but now after completing this case study, it is something I will be more readily thinking about as the future approaches. I will definitely be thinking more about how my decisions affect more than just me. In all three scenarios, the student's actions are far reaching, and affects future students and their ability to secure internships. I learned a lot about the seriousness of the internship, and how important it is to take career and location preferences seriously.

<u>Scenario #1</u>

This was a hard situation because the student wants to go to law school, but still wants to perform the internship. In my opinion if the student knows he wants to for sure go straight into law school, he should tell the firms in interviews because they should know what his or her intentions are, and if they want to take on the risk of said student not returning after the master's year, it is up to them instead of the student. I believe the best option for the student would be doing to the combined J.D. and Master of tax program because he or she would be able to complete both requirements and could then decide what career path is more ideal for them. It is a difficult situation though because the student seems to only be interested in going to law school, and if that is the case they should at the very lease let firms know throughout the interview process, or just not even complete the internship. This is a tough decision to make as the student is most likely not confident in what they want to do, but their decisions and course of action is far reaching, far beyond just themselves. So, while they are just trying to do what is best for themselves, it could reflect poorly upon the school a program in the future. I also don't know if I believe going straight into law school upon completion of the undergrad is the best option, because the student is forgoing a one hundred percent job placement rate with the Patterson school of accountancy, to instead go to law school, to by the time you pay for law school and compare with the years that the student would've been working, make roughly the same income doing a similar job. Overall, I believe the student's best course of action would not be going straight into law school, but if they do want to go straight to law school that they be transparent with the firms through the interview process.

Scenario #2

The second scenario involves two students discussing their future career plans. One student believes that after working a year or two at a big four firm that they may went to filter into investment banking, while the other student would like to get their MBA after a few years at a firm as well. This situation is much different than the previous one, because these students have been transparent with their recruiters and firms, and the firms have told them to go ahead and do the internships in hope of winning them over for the long run. This Is a much different situation because the students have been honest with the firms, and they also have plans of working at the firm for some time before they start to pursue their other career passions. It's not unrealistic that students may follow this path as well because there is a middle exodus within the firms, as some continue on in hopes of becoming partner while others leave and start a new career. Accounting is the language of business, so it is a very versatile major, and can in the future lead to many different career paths. In this particular situation, I believe that the students were right in their actions, as they were being transparent in their motives with the firms, and the firms still wanted to bring them on, so I believe they were in the right.

Scenario #3

The third scenario involves a Masters student who has already completed his or her internship in the Washington D.C. office, and wants to transfer the offer to the Dallas office, his or her hometown. This is an extremely tough situation because we do not know all the details of why they want to transfer their offer, and just have to infer they preferred their hometown to Washington D.C.. The student unfortunately put themselves in a tough situation by not thinking more about where they decided to do the internship in the first place. The internship is where you will end up working after completing your masters and earning your CPA, so the student probably should've thought more about living and working there before applying for internships there. They also asked to transfer their offer assuming that the office they were transferring to had openings, but many of these firms hire the number of interns that they want to take on full time, so the Dallas office might not have space or the capacity for this student. The D.C. office would also be losing money in the training it took get the student trained, and they would be down on what they expected to have for employees. This is not an ideal situation because we really do not know why the student wanted to transfer home, but it would be best if the student waited and worked in D.C., while waiting to get internship transferred. In this situation, it is again important to be transparent through the process, but students should really think long-term about where they want to do their internship because it is often where you will end up working.

Overall, through this case study it is apparent that in every situation it is important to be transparent with the firm about your motives. Each situation is difficult in their own aspect and there really is no right or wrong answer, rather it is important to remember that the decisions being made impact the future generations of students and again reflect upon the school. The internship is a great opportunity to get real world experience before taking the CPA exam and getting a Master's degree, but it is an opportunity that should not be abused.

Case Study #4: Accounting for Debt Securities Sales and Impairments

Case Study #4: Accounting for Debt Securities Sales and Impairments

<u>Case Description and Introduction:</u>

This case study was about debt securities and impairments, and how different circumstances affect whether the debt securities should be impaired. It also addressed the different outcomes of reporting or not reporting as impairments. We examined five different scenarios, deciding what should or should not be classified as an impairment. Impairments occur when an entity owns a debt security that's amortized value is less than the fair value, and it is no longer temporary but permanent. In this case we examined financial documents from a generic bank, and analyzed their financial documents to see the impact of what impairments would do to a bank's net income, as well as how it would affect the rest of their AFS debt securities.

Through this case study, I learned that an impairment occurs when a debt security's fair value is higher than their amortized (book) value as of a certain date. The rulings on what classifies as an impairment is not clear, and can be interpreted differently, which is why the different scenarios often led to different results. I learned that the different ruling bodies of both Accounting and Banking abide by the same, similar set of rules, but generally interpret them to a different amount of regulation. There are many different regulations and governing bodies when it comes to a large, publicly traded bank, as was used in this case study, but still there are discrepancies when it comes to deciding whether or not entity's debt securities that are at loss should be considered impaired or other-than- temporary losses.

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

They would have an impairment loss because they are selling securities, and the securities fair value price is different than the amortized price that is currently in the books. If they sold the seven securities that were aforementioned they would have to report as an impairment loss so that the books could be reconciled to the amount of cash value that they are actually receiving. I arrived at this conclusion because they will not be able to gain interest on debt securities after they have already been sold. Also, they are selling the securities, therefore they do not have the intent and ability to hold the securities until the prices recover, so they have to report an impairment.

2. **Assume that Generic Bank does sell the aforementioned securities shortly after year end in early 20x3. Does Generic Bank have an impairment loss on securities other than the seven securities sold? If so how would you determine the extent of the impairment?**

Generic Bank would potentially have to report impairments on other securities, especially the securities that have been in continuous unrealized loss for greater than twelve months. According the ASC 326-30 mentioned in the case, the bank must make decisions to determine if securities are impaired, or if it is just temporary decline in fair value due to cyclical changes or fluctuations in the market. The bank has reported that the fifty- five investments in an unrealized loss, are all due to interest rates, but if securities have been in continuous loss for greater than twelve months, than more than likely in some part it is due to credit losses. Therefore, they would need to report losses as am impairment. This would represent a gross unrealized loss of $701, 809, to reconcile the books with the fair value market prices of the investments at loss that have been held for greater than a year. On the other hand, if the bank truly believes that they have the intent and ability to hold the other securities until prices recover they would not have the report as an impairment on the others.

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

Yes, as an external auditor, I would be more likely to assume that some of the securities should be reported as impairment losses. As an auditor, you want to make sure the books are accurate and that financial information is being accurately represented, so as an auditor you would be more likely to report the securities that you are more likely to sell before the security at loss recovers. If they think some of the securities at loss are due to credit factors or the present cash flows are less than the amortized value of the bond, than they need to create an allowance for credit losses, so that way values can be accurately represented even if they are not planning to sell the securities in the immediate future. Since this information affects financial users and investors, an auditor would be more likely to report as an impairment just because you wouldn't want to misrepresent information.

As a bank regulator, I would tend toward reporting all securities that are held at loss for longer than a year as an impairment. Even more than that, the SEC has stated that an other-than-temporary decline may happen in a time frame shorter than a year, so potentially as a bank regulator, you would find more of the securities at loss as impairments than you would in a role as an auditor. IN FASB 95 they state that other-than- temporary is not the same as permanent impairment, and that it should not be used to hold securities that are going to have an impairment, so the SEC and bank regulators would probably be stricter about deciding if something should be considered an impairment or not.

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

You would have to report the loss or gains on the ones once they have been sold to match the books. You would want to accurately represent where money would be coming from, so once they are sold you would need to report a gain as well. On the ones that are not for sale you would not need to report because you are not actively selling them, and they are above the book value cost so it is something you do not need to worry about not potentially recovering. You would still need to evaluate each security as its own entity to see if there are any securities that need to be reported as an impairment, even if there is an overall net gain. If all securities were sold in gain position, then there would be no impairments thus no reason to report impairments.

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.

5. Assume that Generic Bank does sell the aforementioned securities shortly after year

end in early 20x3. Does Generic Bank have an impairment loss on securities other than the seven securities sold?

Since they are just adequately capitalized, rather than well capitalized, it might change whether or not they have to report more of their securities at loss as impairments. Since they have less money, and their ways of borrowing to meet liquidity are more limited, it would make them more likely to have to sell some of their AFS securities in the near future. The conditions or event of them having to sell the security has gone up, because they have less money they are more likely to have to sell the securities in the future. So, if they are more than likely going to have to sell the impaired security before the amount recovers to the amortized value of the security, then they need to report the difference between values as an impairment and write down the value of security to match its fair value. Being less capitalized increases their likelihood of having to report their securities at loss as impairments because they are more likely to have to sell them to stay adequately funded.

Case #5: City Selection Case

Case #5: City Selection Case

Case Description and Introduction:

This case study was very helpful and interesting, as it pertained to my future career and living arrangements. The two cities that I am looking at most to intern and continue my career at are Dallas, Texas and Atlanta, Georgia. Dallas, Texas is my favorite because I enjoy the climate and opportunities offered, as well as have extended family in the area. I also very much enjoy Atlanta because I like the opportunities offered, different activities, and have family friends in the region. In this case study, we examined many different factors about the cities we were looking at living in from crime to rent to fun activities to get involved in in each city. In this activity, we also looked at potential rents and places in which we would live, and created budgets off of all the info we looked at, and it was very interesting seeing how the budget changed and adjusted in each of the places I was looking at living at. In both situations, there were factors that I did not change or compromise on, such as living somewhere safe, living with at least one other roommate, and living in an apartment complex that contained either a washer/dryer unit in the apartment or in the complex. These were a few things I will be unwilling to compromise on in the future.

This case study helped to reassure my thoughts and ideas of where I would like to work and live upon graduation. I was reassured that I could live in or around my desired location in Dallas within my budget, so that I would be able to be both near my desired neighborhood as well as near employment, limiting the amount of time spent commuting to and from work. After doing this activity I have realized that where I would want to live in Atlanta would actually be costlier than living in Dallas, and I had previously assumed it would work out to be the other way. It was also reassuring see how after all costs and expenses I would still have money to spend on fun things and use to spend on exploring my new city, as well as potentially exploring other places with saved funds across the united states. I still really like Atlanta for all the opportunities in the industries and friends in the area, but this case study reaffirmed my thoughts that Dallas is my number one city and Atlanta my second.

1.What is the population?

Dallas:

1.341 million in the city limits, but 4.9 million people in the entire metropolitan area.

Atlanta:

486,290 within the city limits, but there are 5.9 million people in the metropolitan area.

2. Describe the climate and seasonal fluctuations.

Dallas:

Winters are usually mild, summer is normally hot and dry, and spring and fall months are generally very pleasant.

Atlanta:

Summers are hot and humid, but with very mild winters with lows in the upper 30s generally. Spring and Fall are generally a little drier, but mild as well.

3. Describe the city's topography, scenery, and other geographic or geological features of

the area in which the city is located. Include pictures where appropriate.

<u>Dallas:</u>

Dallas is a relatively flat area, but contains parks and small water features as well as high rise buildings.

3. Dallas Uptown

3. Dallas Skyline

<u>Atlanta:</u>

Atlanta is generally a flatter city wither a high elevation located somewhat in between the Atlantic Ocean and Chattahoochee river. The metropolitan consists of high rises and the further you get out the more tree coverage exists.

3. Brookwood Atlanta Neighborhood

3. Atlanta Skyline

4. What are the individual tax rates within the city (e.g., consider federal, state and local

income tax, property tax, and any other taxes you'd be likely to pay. Quantify what this means based on a starting salary of approximately $50,000/year)?

Dallas:

In Texas, there are only federal income taxes and FICA taxes taken out of income which are $4500 and $3800 respectively, which would make net take home income $41,700 a year. Property taxes are also paid for by whomever owns the apartment so I would not have to pay those while living in an apartment.

Atlanta:

In Atlanta, there are state and federal income taxes which are 4500 and 2500 respectively, as well FICA taxes which would be 3800. This would have net take home income of $39,200 income per year. Again, in Atlanta I would be living in an apartment, so there would be property taxes already factored into the rent payment.

5. What transportation hubs are in the city?

Dallas:

In Dallas, there are two major airports: the DFW airport and Dallas Love airport. There are also interstates, walking trails, highways, a public transportation DART rail system, and a trolley through midtown and downtown.

Atlanta:

In Atlanta, there is one major airport, the Hartsfield- Jackson Atlanta International Airport. There are also interstates and public transportation consisting of MARTA buses and trains, Atlanta street car, and Gwinnett County Transit.

6. What is the city's most prevalent industries?

Dallas:

The major industries include defense, financial services, information technology and data, life sciences, semiconductors, telecommunications, transportation, and processing.

Atlanta:

The most prevalent industries are financial services, technology, telecommunications, and food and beverage.

7. Describe the quality of the city's healthcare?

Dallas:

Hospitals consistently ranked top in America. Baylor University Medical Center ranked. Seven major healthcare systems located here. There are also large area insurers, but I assume that the firm I work with would help to pay some for medical insurance.

Atlanta:

As a state, Georgia's health care is not as strong, but within Atlanta there is good access to quality health professionals, for instance there is Emory health care services based in Atlanta.

8. What types of crime are common within the city and where are the locations within the city to avoid?

Dallas:

Like any large, metropolitan city, there are drug crime, gang violence, robbery, and prostitution in Dallas. These crimes are largely limited to the same areas to be easily avoided and include Western Park in Southwest Oak Cliff, West Dallas, Pleasant Grove, and South Dallas.

Atlanta:

In Atlanta, there is crime similar to any large metropolitan city, such as drug crime, violence, homicide, and robbery. Heavy crime areas to avoid would be U-Rescue Villa, Old Fourth Ward, Kirkwood (which is known for gangs), Castleberry Hill, Washington Park, Edgewood, Peoplestown, Vine City, and East Atlanta Village.

9. Based on where you see yourself living for the first three years, how much rent do you expect to pay? Back up this assertion with sample properties from each location (including pictures). Describe the square footage, amenities, need for a roommate, availability of parking, etc.

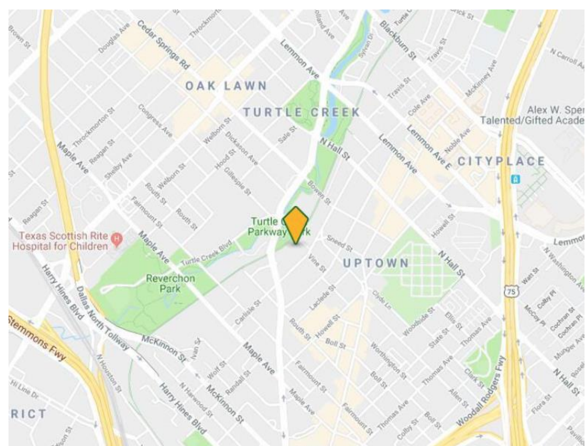
Dallas:

I plan on living with at least one roommate because I would prefer to not live alone my first couple years, which also helps to make my future apartment/ living arrangements more affordable. I would want to live amongst people of the similar age and stage of life, so I would hope to live in the uptown, lower Greenville, or similar neighborhood of downtown Dallas. Rates in these neighborhoods vary but for the most part would lie between $850 to $1100 per month in rent. In a two- bedroom apartment in my desired neighborhood, there are 956 square feet and includes two bedrooms and two bathrooms. Amenities in this apartment facility include direct access to Katy Trail, in the Uptown Dallas neighborhood, Bicycle storage, pool, washer/ dryer, gated, fitness center, and Wi-Fi. Parking is also included with an assigned parking lot in a surface lot.

9. Dallas Apartment plan

9. Dallas Apartment Building

9. Dallas Apartment Building



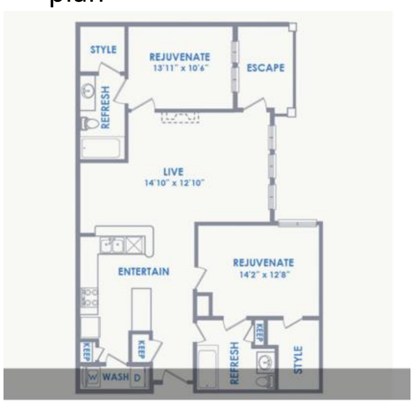
9. Dallas Apartment Location

<u>Atlanta:</u>

I would plan on living with at least one other roommate if I were to live in Atlanta, which would help to make my living arrangements more affordable. I would want to live somewhere safe, but also fun and surrounded by people in similar stages of life, so I would hope to live in the

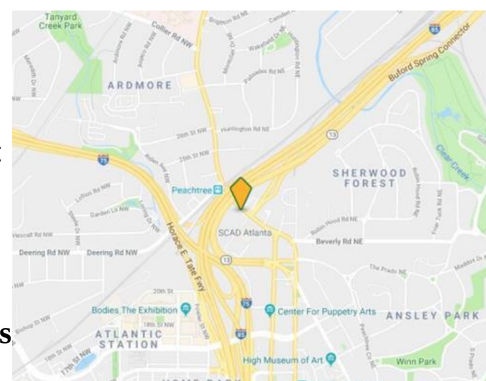
Buckhead, Brookhaven, Vinings, Inman Park, Cabbagetown, Brookwood or similar neighborhoods as they would match my needs best. Rent for two to three bedroom apartments in these areas are $900 to $1100 per month per person. For example, 1660 Peachtree Apartments which is in one of my desired neighborhoods, has a two-bedroom, two-bathroom apartment for $1849 with 1164 square feet. Amenities included are a parking garage, washer/dryer, convenient location, pool and fitness center, a car care center, and close to the Peachtree train station.

9. Atlanta Apartment plan



9. Atlanta Apartment Building

9. Dallas Apartment Location



10. What is the typical mode of commuting? Bas[illegible] prior question, what are your likely commute times?

Dallas:

In Dallas, the most popular way to commute would be to drive, but from midtown there is also a train option. However, where I would want to live is very close to all the firms so my commute time would be very short. It would be a 5-7-minute drive, or I could potentially even walk the 1.3

-1.5 miles to the firm. There is also a trolley route I could take but driving would be much more efficient so I would most likely drive.

Atlanta:

The typical mode of transportation is Driving, but if I am able to live in my desired neighborhood, I would likely be able to use the MARTA public transportation if I like it, but I would have to experience one way or another before I decided which method I would use. Based on my apartment location listed above it is only 3.7 miles away would be a 12- 19-minute drive or a 25-30-minute bus ride to where the firms are located.

11. Where will you do your grocery shopping?

Dallas:

There is a Walmart Neighborhood Market, Kroger, Trader Joe's, and Whole Foods all within 15 minutes of my desired living location, so I would probably do my grocery shopping at Kroger and the Walmart Neighborhood Market for the most part, since I will have a car and would be able to travel with it.

Atlanta:

There is a Kroger and Aldi in both neighborhoods I would enjoy living in, that are easily accessible and affordable. I would most likely shop at both getting the basics at ALDI and the name brand food items at Kroger.

12. How will you do your laundry?

Dallas:

I would do laundry at units within apartment (I picked only apartments that included either a unit within the apartment or a unit within the complex).

<u>Atlanta:</u>

I would do laundry at units within apartment (picked only apartments that included either a unit within the apartment or a unit within the complex).

13. Name at least three civic, religious, or charitable organizations you would like to be active

in for each city?

<u>Dallas:</u>

Three things I would like to get involved in would be the Watermark Community Church, The Porch Light Bible Study, Tuesdays at 7:00 pm, and become a volunteer for the Boys and Girls Club of Dallas.

<u>Atlanta:</u>

Three things I would like to get involved in would be Grace Midtown Church, the Wednesday Evening bible study and service at 7-8:15 pm, and become a volunteer for Boys and Girls Club of Atlanta.

14. What are the sports, entertainment, or recreational activities that you would be most likely to engage in within the city. Name at least five activities.

<u>Dallas:</u>

1. Pickleball (local YMCA league)
2. Texas rangers (MLB baseball team)

3. Dallas Mavericks (NBA team)
4. Billy Bob's Honky Tonk (concert venue and dance club)
5. Ole Miss Alumni Group - Dallas (watch Ole Miss events and network)

Atlanta:

1. Atlanta Braves (MLB Baseball team)
2. Atlanta United soccer team (MLS soccer team)
3. Pickleball (local YMCA league)
4. The Fox Theatre (Musicals, Plays, Concerts, etc.)
5. Ole Miss Alumni group – Atlanta (watch Ole Miss events and network)

15. What are the modes of traveling back to your hometown from this city? What is the average cost you'd incur for each trip back home?

Dallas:

A round trip from either Dallas area airport to Indianapolis would cost around $284. I could also drive home in a little over 13 hours which would cost 180-240 in gas and car costs.

Atlanta:

A round trip flight from Atlanta to Indianapolis on Delta would be 199.40 or roughly $200. I could also drive which would be a 9-hour drive which would cost roughly 100-150 in gas and car costs.

16. Based on your findings, develop a model monthly operating budget for each city for

Year

2, assuming that with bonuses for being a high performer, your annual salary is $60,000.

Dallas Monthly Budget:

Dallas Budget			
Total income for year	60,000	Savings/ investments	$ 815.17
(taxes)	-11,090	401k	$ (244.55)
net pay	48,910	savings deposit	$ 570.62
monthly income	$ 4,075.83		
Needs:	$ 2,037.92	Wants:	$ 1,222.75
rent	-900	gym membership	-60
groceries	-200	movies and shopping	-200
gas	-100	tithe	$ (407.58)
utilities	-150	eating out	$ (250.00)
health insurance	-150	fun trips savings	$ (100.00)
car insura ce	-70	other wants	$ 205.17
phone paymnt	-50		
other needs	$ 417.92		

Atlanta Monthly Budget:

Atlanta Budget			
Total income for year	60,000	Savings/ investments	$ 763.33
(taxes)	-14,200	401k	$ (229.00)
net pay	45,800	savings deposit	$ 534.33
monthly income	$ 3,816.67		
Needs:	$ 1,908.33	Wants:	$ 1,145.00
rent	-950	gym membership	-60
groceries	-200	movies and shopping	-200
gas	-150	tithe	-381.67
utilities	-150	eating out	-250.00
health insurance	-150	fun trips savings	-100.00
car insura ce	-70	other wants	$ 153.33
phone paymnt	-50		
other needs	$ 188.33		

17. Finally, based on your full analysis, determine whether you still want to live in both cities,

and if so, which one is your preferred city and why?

I would still like to live in both cities because they both offer great opportunities, and I feel as if I could be successful and happy in both places. This case study did however affirm that Dallas is my first-choice city. Upon graduation, I want to live in the city, yet still in a safe and fun area, and I feel like this is more possible in my budget if I were to be living in Dallas versus Atlanta. I still really like Atlanta however, so I would still enjoy being there if that is where the opportunities end up presenting themselves. Dallas also allows me to be closer to family if needed, and still has many of the fun and exciting activities that a city can offer a young professional.

Case Study #6: WorldCom

Case #6: WorldCom

Case Summary and Analysis:

This case was about WorldCom and focused on capitalization of assets and expenses, and when each should occur. WorldCom was one of the two big accounting scandals that led to the creation of the Sarbanes- Oxley Act, after extreme amounts of fraud occurred at WorldCom and Enron, with both being audited and advised by Arthur Andersen, which ultimately led to the closure of the firm. In the example of WorldCom, they were capitalizing expenses as capital assets that should've just been classified as expenses, as they were just using other telephone lines and making costs that were just essential to business capital asset expenditures.

This case examined a real-life situation where things went very wrong. A simple accounting error to try and delay costs until revenues increased resulted in mass numbers being wrong and ultimately the shutdown of two companies. This case study helped to outline the importance of honest accounting, and the mass effect wrong accounting can have on the entire business and financial wellbeing of the company. Through this case I can see the importance that public accountants have, and how serious it is that in the future we do our jobs, and we do them well. The first tip off in seeing that something is wrong though was that the exact same number was reported for line costs in both 1999 and 2001, which is extremely unlikely as 2000 was a year where they experience more expenses, so more than likely in 2001 they would've had more as well. This case helped to illustrate the importance behind ethics in accounting, especially in being faithful in reporting the right things as assets and expenses, as well as the right numbers.

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

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

SCON 6 defines an asset as something that will give you future economic benefits as result of a past transaction or event. It describes as expense as an outflow or using up of asset of incurrence of liability during a period, resulting from delivering or producing goods, performing services, or other activities that relate to the business's operations.

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

Costs should be expenses when they are just a routine aspect of business, and the thing being done provides no extra benefit to the company. It should be capitalized if it is for building a unique asset, and or a very limited time, and more importantly changes the future cash flows of the business.

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

They are added to the assets, so the assets side of the balance sheet will immediately increase. The first year, the income statement will also show an exceptionally high income because none of the costs capitalized the first year will appear as an expense on the income statement. Slowly parts of the capitalized costs will appear on the income statement through depreciation expense, but depending on the depreciation method and years until salvage chosen, it could be a very immaterial amount of it for times.

c. Refer to WorldCom's statement of operations. What did the company report as line costs for the year ended December 31, 2001? Prepare the journal entry to record these transactions for the year. Explain in your own words, what these "line costs" are.

In 2001, WorldCom reported line costs of $14,739 million. Their journal entry for this year most likely looked something like:

(in millions)

12/31/01	Line Cost Expense	$14,739	
	Accounts Payable		14,739

The line costs were essentially costs that had to be paid to other phone company line operators when calls when outside their area. So, the majority of line costs were outflows to other companies to pay for using their telephone line services.

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

WorldCom was improperly classifying a significant number of charges paid to local telephone lines as capitalized costs, rather than classifying these as expenses as they should have been rightly classified. By doing this World Com effectively turned a loss for 2001 into a profit. The costs paid to other telephone line companies do not qualify for capitalization costs because they are focused on current expenditures, rather than a long-term improvement project. Most of the costs were just expenses that should've been expensed, but WorldCom capitalized them in hopes they would be garnering more revenue by the time these capitalized costs would be depreciated.

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

Improper Journal Entry (in millions)

12/31/01	PPE (Transmission Equipment)	3,055	
	Accounts Payable		3,055

The incorrectly capitalized costs most likely appeared on the transmission Equipment part of PPE, but most definitely appeared within the Property and Equipment section of their balance sheet. In the statement of cash flows the costs appeared under the investing section in the capital expenditures section, as they were referred to PPE costs and being capitalized, so the were improperly classified as capital expenditures.

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

Calculate the related depreciation expense for 2001. Prepare the journal entry to record this depreciation.

Calculations (in millions):

Quarter 1 – 771/22 x 4/4 = 35.045

Quarter 2 – 610/22 x ¾ = 20.795

Quarter 3 – 743/22 x ½ = 16.886

Quarter 4 – 931/22 x ¼ = 10.580

Total depreciation expense for 2001= $83.306

Journal Entry to Record Depreciation (In millions):

12/31/01 Depreciation Expense	$83.306	
Acc. Depreciation- transmission equip.		83.306

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

Net Income before tax as reported, 2001	2,393,000,000
(incorrectly capitalized expenses)	-3,055,000,000
add: uneccessary depreciation expense	84,125,000
Adj. Net Income before tax, 2001	-577,875,000
tax rate	35%
income tax	0
Adj. Net Income tax, 2001	-577,875,000

The difference in net income is material. Where they were before earning a net profit, they are now reporting a net loss, and a rather material and significant number at that. Assuming that they do not have to pay income taxes since they are not earning income, that number is even more significant because there is nothing taken out of it, they are just reporting a loss.

Case Study #7: Starbucks Corporation

Case #7: Starbucks Corporation

Case Description and Introduction:

This case was about Starbucks and their financial statements and comparing them using common-size income statements using percentages as a comparable base. The income statement compares on a basis of revenue, while the common- size balance sheet compares percentages with total assets as a basis. The case used real statements from Starbucks to analyze their performance across 2012 and 2013. Through this case study we identified different points that stuck out within the statements and identified things that changed throughout the two years.

I learned a lot about analyzing financial statements through this case study. I had never done common-size financial statements looking at both the income statement and balance sheet using comparable base numbers comparing as a percentage. It is interesting to see how assets, liabilities, and equity accounts change in relation to the total asset accounts of the current year. It was also interesting to look at how it was interrelated especially compared to total revenue. This case study looked at a real company, Starbucks, and how different things on the financial statements interrelate and affect the overall bottom line and earnings per share.

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 makes money by opening stores and selling food and drink within the stores, as well as selling merchandise, food, and beverage to other retailers. Based on the balance sheet, they also earn income from investing in other entities outside of Starbucks.

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

Commonly consolidated statements for public accounting are the income statement, balance sheet, and statement of cash flows. Starbucks gives these statements their usual name, but put consolidated in the title of the sheet. For instance, the income statement is labeled Consolidated Statement of Earnings. Consolidated means that similar items are grouped together, and accounted for together, rather than listing each item individually line by line, which would make the statements hard to read and understand. Intercompany transactions especially have been eliminated.

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

Typically, they prepare financial statements four times a year with deadlines of 45 days after quarter ends, and 90 days after year end close.

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.

Management and Finance within Starbucks are responsible for creating financial statements, but there are many more users. Investors and potential investors are users of the financial statements, as well as the management within the company. The information they are interested in is revenue and earnings per share. Some investors may decide to use other lines from the income statement or balance sheet to calculate different ratios, but EPS is one of the biggest line items investors will look at.

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?

Deloitte is Starbucks' external auditor. The team out of the Dallas office is in charge of managing the audit. The first opinion letter states that they believe Starbucks has reported numbers fairly and correctly under PCAOB standards, and that their audit opinion found reasonable basis to believe this, and therefore issued a clean, unqualified opinion. The second opinion letter is more related to their internal controls, and they assessed and believe Starbucks has the proper and necessary internal controls in place. They are dated a couple months after year end because the companies must close the books and prepare the statements before getting audited, so it may take the audit team some time to complete the audit to come to a reasonable basis on the matter.

F.

CONSOLIDATED STATEMENT OF EARNINGS AS A PERCENTAGE OF NET REVENUES

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

Cash dividends declared per share	0%	0%

CONSOLIDATED BALANCE SHEET AS A PERCENTAGE OF TOTAL ASSETS

Consolidated Balance Sheets (USD $)	2013	2012
Current assets:		
Cash and cash equivalents	22%	14%
Short-term investments	6%	10%
Accounts receivable, net	5%	6%
Inventories	10%	15%
Prepaid expenses and other current assets	2%	2%
Deferred income taxes, net	2%	3%
Total current assets	48%	51%
Long-term investments	1%	1%
Equity and cost investments	4%	6%
Property, plant and equipment, net	28%	32%
Deferred income taxes, net	8%	1%
Other assets	2%	2%
Other intangible assets	2%	2%
Goodwill	7%	5%
TOTAL ASSETS	100%	100%
Current liabilities:		
Accounts payable	4%	5%
Accrued litigation charge	24%	0%
Accrued liabilities	11%	14%
Insurance reserves	2%	2%
Deferred revenue	6%	6%
Total current liabilities	47%	27%
Long-term debt	11%	7%
Other long-term liabilities	3%	4%
Total liabilities	61%	38%
Shareholders' equity:		
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0%	0%
Additional paid-in capital	2%	0%

Retained earnings	36%	61%
Accumulated other comprehensive income	1%	0%
Total shareholders' equity	39%	62%
Noncontrolling interests	0%	0%
Total equity	39%	62%
TOTAL LIABILITIES AND EQUITY	100%	100%

G. Refer to Starbucks' balance sheet for fiscal 2013 (the year ended September 29, 2013).

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

On the consolidated balance sheet account, the accounting equation is balanced so it holds true.

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 Cash Equivalents, Inventories, and Property, Plant, and Equipment. The short term to Long term asset ratio is short term 48% to long term 52%. This seems appropriate because Starbucks is a food service so they will have lots of short term inventory items, cash, and other liquid assets, but they also operate their food service out of many brick and mortar stores worldwide so they have many long-term assets and property, plant, and equipment.

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

Intangible assets are assets that are not physical but intellectual property or financial instruments. Goodwill occurs when Starbucks buys a company or large permanent asset, goodwill accounts for the difference between purchase price and cost of actual asset. Specific intangible assets could include acquired rights, different trade secrets, trademarks and licensing agreements, patents, and copyrights. These things that have no physical value but still have monetary value, other than goodwill.

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

Starbucks is financed by both debt and equity. The debt financing comes from long term debt, while the rest of the financing comes from Common Stock financing. The proportions are 4480.2 divided by the total liabilities and equity (11516.7) which equals 38.9%, which means the financing by debt is 61.1%.

H. Refer to Starbucks' statement of earnings for fiscal 2013 (the year ended September 29, 2013) and to the common- size income statement you develop 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 judgements management needs to make in recording sales revenues at Starbucks?

Starbucks records revenue using different methods depending on where the income comes from. For instance, company-operated stores revenues are recognized when payment is tendered at the point of sale. According to the case, "the sales of coffee, tea and related products are generally recognized upon shipment to licensees, depending on contract terms". Lastly, Revenues from our stored value cards, primarily Starbucks Cards, are recognized when redeemed or when the likelihood of redemption, based on historical experience, is deemed to be remote.

ii. What are Starbucks' major expenses?

Starbucks' major expense include store operating expenses, Litigation expense (2013), and the cost of sales including occupancy costs.

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

Yes, in the past year they had a large litigation expense that they did not have in the previous two years that they hadn't needed to account for.

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 carrying amount of reserve for known or estimated probable loss from litigation, which may include attorneys' fees and other litigation costs, which is expected to be paid within one year of the date of the statement of financial position. It's important for its own line item so that investors know it is a one-time expense rather than recurring.

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

A company is profitable earning a profit after expenses have been matched to revenue for the period. They were profitable in 2012 but not 2013, because if you look at earnings before income taxes they are negative which means they were not turning a profit.

I. Refer to Starbucks' fiscal 2013 statement of cash flows

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

In 2013 the net earnings are much lower than net cash provided, which means there was more cash outflowing than inflowing, especially compared to 2012 when both numbers were higher. The difference is net income accounts for depreciation and other non-cash assets and expenses, while net cash provided accounts for the movement of cash through the operating activities.

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

Starbucks spent 1,135.9 million Property, Plant, and Equipment during fiscal 2013.

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

They paid 628.9 million dollars in dividends during the year. This amount is comparable to the amount declared of 666.9 million dollar's worth declared. The amount in the equity section is the amount declared, so the amount announced that they will pay, while the amount they actually paid are the dividends that were both announced and then dividends payable account cleared for.

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

The accounts that require estimates are deferred income taxes, inventories to some extent, intangible assets, goodwill, and deferred revenue. Any accrued account is estimate free because it means that the numbers have already been accounted for. Another account that would not be an estimate is cash and cash equivalents because the company should have a real-time bank update of what is going on.

Case #8: BP p.I.c. – Contingencies

Case #8: BP p.I.c. – Contingencies

Case Description and Introduction:

This case study was about the BP oil spill and the contingent losses and accounting methods they used. It addressed what could be considered a contingency, and if this was the best method to account for the losses that they were bound to face from the oil spill. We also analyzed their situation to decide what we would count and estimate for as losses if we were BP's auditors. The oil spill took place in 2010, and we are examining data in 2019 so we have outside information that they did not have when they were making these decisions, and can see where their original estimates were not accurate.

Through this case study, I learned more about contingencies and how large losses can often be hard to estimate. BP was able to reference the Exxon Valdez loss as a guiding point, but their actual loss was much greater, and was originally not accounted for that way. This case study also looked at how many people could be affected by a disaster like this, and how far their liable losses stretched. This case study taught me how difficult it is to estimate the reach and depth of some contingent losses. Accounting rules also say you do not report contingent losses, unless they are both probable and estimable, and some of these losses were inestimable so it delayed in their reporting even though they were going to be large losses so they should've been reported more immediately.

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

A contingent liability is an existing problem, circumstances, or situation that involves uncertainty relating to a future loss. A company records a contingent liability in its books when the occurrence is both likely to occur and the amount of the loss is estimable in quantity. If the liability is not estimable, then it is not recorded, but instead noted in the foot notes, while if the contingent liability is only reasonably possible or remote it is not accounted for, and may be mentioned in the footnotes. Some examples of contingent liabilities would be warranties, legal disputes that they expect to lose, and expected losses from natural disasters. Contingent gains can occur, for example if a company expects to win a legal dispute, but these gains are not recorded as contingent assets, instead just included in other gains and losses on the income statement.

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?

The product warranty for BP is not accounted for in the books because it is not separate from the product, but it would be included in the footnotes of statements, making notice that they do have a warranty that can help protect against future losses for the two- year period. For GE Oil and Gas, the warranty amount that they expect to be needed to cover any warranty claims would be debited to warranty expense, and they would make notes in their footnotes that they sold their products with a warranty. It would be considered a contingent liability, and the amount that they expect to lose in replacement and repair costs would be counted as warranty costs.

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 decide if costs of contingent liabilities are probable, reasonably possible, or remote. They only account for contingent liabilities on their books that are probable and estimable. Pertaining to accrued warranty costs, they need to account for the estimated dollar amount that they expect to have to use to provide in resources, labor, etc. to provide warranty to their product. A claim for damages resulting from the Deepwater horizon oil spill differ from warranty because the loss amount is much greater and companies do not estimate such large contingent liabilities because the chance of it occurring is remote. When it does occur, they have to account for it as claims appear and come in versus with warranties they are able to use their warranty liability account to cover the costs of repairing and replacing.

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.*

As soon as the oil spill occurred they needed to account for their predicted environmental impact loss contingencies, predicted loss from local businesses law suits, and lawsuits associated with the eleven deaths of the people operating the rig. The Exxon Valdez oil spill ended up causing them an economic loss of nearly three billion, so BP should've looked at their numbers as a base point to start estimating their contingent liabilities from. BP's oil spill, however, was much larger and impacted more people so they should've accounted for this in their estimates, which now we see almost 10 years later that they grossly underestimated many of these liabilities. In 2018, BP stated that they had spent almost 65 billion dollars related to the Deepwater oil spill, which has resulted in shareholders suing as early on they reported the costs to be lower.

d. part 2. If you were the auditor for BP, how do you draw boundary around potential losses?

The BP oil spill took place in the Gulf of Mexico, and ended up affecting a lot of different types of people and businesses. Some of the different people and businesses that could sue are coastal tourism businesses, families of injured workers, fisherman, the government, and lastly the shareholders for underestimating the cost of the oil spill. As an auditor, you could draw boundary around potential losses by determining what is estimable and probable to occur. They would've been able to base some of it on the previous losses suffered by Exxon Valdez oil spill, but because this one was so much larger and father reaching, they would have to estimate further and larger costs. I think they have to estimate the costs that they will be paying and adjust from there, just because the exact amount may not have been estimable, they should have been estimating more, so that they were not misleading shareholders. It's reasonable if they are estimating the costs that they will be facing and enduring, and debiting an expense account or prepaid liability account for the amount they believe they will have to pay.

Case #9: The Wendy's Company

Case #9: The Wendy's Company

Case Description and Introduction:

This case study looked at the Wendy's Company, joint-ventures, and accounting for investments using the equity method. It addressed how and when the equity method of accounting was used, and the impact of joint-venture activity on an overall company. In this case, it was Wendy's partnering with Tim Horton's in Canada to open TimWen's, which were combo restaurants that offered both Wendy's and Tim Horton's. Through this case we analyzed if this joint-venture had been financially successful, and the impact the joint-venture had on each of the consolidated statements.

Through this case study I learned the importance of accounting properly for joint-ventures or other large equity investments. The equity method of accounting has limited uses, reserved for when companies make large investments in things such as joint- ventures where they become a large equity owner. This case study also helped to teach the importance of using financial statements, and especially the footnotes to learn more about a company's joint- venture activity and disclosure. I learned a lot about the impact of different financial accounting methods through this case, and how each affects the way entries should be recorded. I learned how businesses might put their losses related to equity investments in other operating expenses on the consolidated statement of operations, and the overall impact it has on the financial statements of the company, especially net income.

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

Companies enter into joint-venture agreements for multiple reasons. Often, they join to reach a common goal or expand their influence. Joint-ventures offer flexibility and are a good way to build new business faster. It also helps to diversify risk, as a single company's investments are spread across multiple entities rather than just their own. Joint- ventures also help companies enter foreign markets and can benefit both companies involved.

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.

The equity method is a method of valuing securities, stocks, and investments in a way in which the investment's carrying amount is increased or decreased by the investor's proportionate share in income or losses, and is also decreased by all dividends received from said investment. This method of accounting is only used when a company owns 20 to 50 percent of the other company or venture, whether it's in form of stocks, investments, securities, etc., because the investing company is then said to have significant influence, therefore it is important that the company reflects this in their statements, and thus uses the equity method.

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?**

The net assets are equal to equity, which means the investor would've paid more that the equity per share price, which indicates there was goodwill accounted for in the transaction. The investor can write up identifiable assets and liabilities to fair value, and then the rest of the excess between the purchase price and fair value can be attributed to a goodwill account.

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?**

They included the equity income on the balance sheets under other operating expense, net, since when recording amortization and depreciation they were debiting equity income and crediting the equity investment. The income for 2012 and 2011was $10,551 and $10,571 respectively. It appears as an expense/ credit because they also invested in a Japanese company, but the loss they experienced was more than the initial investment in the company.

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

On December 30, 2012, the carrying value of the investment exceeded the interest in the joint venture by $54,088. This means that because of purchase price adjustments from the merger, amortization, and goodwill, Wendy's 50 percent portion of equity in TimWen is $35,282. This was calculated by subtracting $54,088 from $89,370, which was the balance at the end of the period (December 30, 2012). The difference between these two amounts is accounted for in amortization of purchase price, and appears in the statement of operations in other operating expenses, net.

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?

This affected Wendy's consolidated statement of operations because they experienced an initial loss in their investment before taxes in 2012 and 2011, so it lowered their pre- tax income because Wendy's buried these losses in the other operating expenses, net account, which lowers net income, therefore lowering their earnings before taxes.

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

Equity Investment	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.***

The amount of the amortization of the purchase price adjustments in 2012 would be $3,129, because it has a useful life of 21 years and it would be considered an identifiable asset.

Equity Income	3,129	
Equity Investment		3,129

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

They received $15,274 and $14,942 thousand in 2012 and 2011 respectively.

Cash	15,274	
Equity Investment		15,274

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

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

You have to subtract equity income from the statement of cash flows because it is essentially a gain that was already included in net income. Since it was a non-cash transaction, it isn't accounted for in the statement of cash flows because no cash was exchanged, which is why it needs to be subtracted out net income. If you subtract $1,827 (equity loss) from $10,551 (equity gain), you arrive at the $8,724 number reported for net equity in earnings. Overall, TimWen increased Wendy's earnings both years.

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.

This amount comes from the distributions from the joint-venture, and while it lowers the amount in the equity investment, it is still an increase in cash coming in for the Wendy's Company, so to reconcile it to the statement of cash flows they would need to add back the distributions received from joint venture to arrive at a net cash from operating activities.

Case #10: Johnson & Johnson – Retirement Obligations

Case #10: Johnson & Johnson – Retirement Obligations

Case Description and Introduction:

This case was about Johnson & Johnson and their retirement plans and defined benefit plan accounting. Through this case we analyzed the impact of planned benefit obligations versus the plan assets account. In this case we further looked into the impact of actuarial assumptions on retirement planning. We also looked at the difference between defined benefit plans and defined contribution plans.

This case taught about retirement benefit planning. I learned how to read and analyze retirement benefit footnotes associated with pensions. I learned more about expensing and funding retirement benefit obligations. We further looked at the impact of actuarial assumptions on pension expense, assets, and obligations on financial statements and retirement planning.

a. There are two general types of retirement (i.e. pension) plans—defined benefit plans and defined contribution plans.

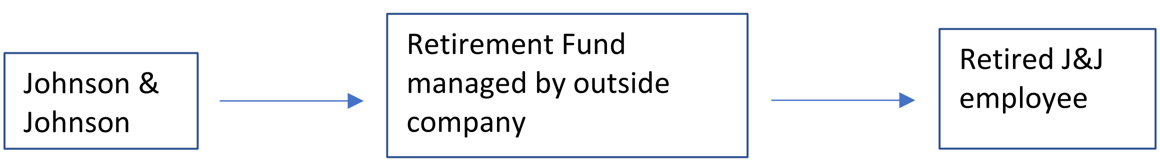
i. How do these two types of plans differ? Which type does Johnson & Johnson have?

Defined benefits are promised benefits to an employee when he or she retires, it is dependent upon many outside factors how much a business will eventually need to pay.

Defined contributions plans are plans where an employee defines amount that they are going to contribute to a retirement plan and that is the amount that they will have at the end of year when he retires. From the case notes you can see that Johnson & Johnson has different plan options for employees, but they primarily use and look at the financials of the defined benefit plans. These plans were very popular, but as life expectancy grows, many more companies are switching to the more predictable defined contribution plans.

ii. Explain why retirement plan obligations are liabilities.

It's a liability account because in relation to the defined benefit plans they do not know the exact money that they will need to provide to their retired employees, and until they are all paid out it will be considered a liability account.



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

Businesses and firms have to make quite a few assumptions in regard to retirement plan obligations. Some that they must account for and make educated assumptions about interest rates, life expectancy, mortality rates, future salaries, and expected years that an employee will work before retiring.

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

Service costs are the costs of each additional year worked by the employee, so they are a future expected cost that they account for now. Interest costs are the related interest expense cost that is accrued on the potential benefit obligation. Actuarial Gains or Losses are the large gains or losses associated with major estimates changing affecting future potential benefit obligations. An example would be a cure to cancer being discovered, because it would change life expectancy causing there to be an actuarial gain or loss. Another example would be the interest rates on the plan assets changing than what was expected by a large enough amount that it is outside the accepted corridor, causing an actuarial gain or loss. Benefits paid to retirees affect the plan assets and the potential benefit obligation, because it decreases both of them because they pay the retiree out of the plan assets, but because they have also been paid a certain, predetermined amount it also decreases the plan obligation amount because they are no longer obligated to pay that amount.

c. In general, companies' 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. Explain each of the three items in your own words.

Actual return on pension investments is the actual return the plan investments are earning. The plan assets do not just sit somewhere, but rather are invested in places where they can earn interest, so the actual return on pension investments is the money the plan assets are earning and ultimately being reinvested into plan assets. Company contributions to the plan are the monetary contributions that the company adds to the pension plan assets. It is the additional investment of cash that a company contributes to the plan, especially if they realize that their plan assets do not match their potential benefit obligation. As previously mentioned, benefits paid to retirees decrease the plan assets account as it represents the money that is being withdrawn by the former employees. It is why the plan assets exist in the first place, so it where they withdraw on their pension.

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

The two returns differ and are utilized for different things. The "return on plan assets" component that impacts the plan assets account is the actual return on plan assets. This is the amount that is actually changing the balance in the plan assets account. The "return on plan assets" component that affects pension expense is the expected return on plan assets, which is what the company predicts the return to be. When the expected and actual differ, that is treated as a gain or loss, but as long as it falls within the corridor it will show within the pension expense account.

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?

The primary difference between the other benefits they offer and its retirement plan is that the other benefits can be utilized while an employee works at the company. The retirement plan, on the other hand, cannot be accessed until after the employee retires. But or retired employees the primary difference is that the extra benefits are provided mostly to only U.S. employees since government programs sponsor most foreign retired employees, while the pension is provided to employees worldwide.

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 and Johnson reported $646 million in pension expense (or net periodic benefit cost) on its 2017 income statement.

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

Service Cost	597	
Interest Cost	656	
Projected Benefit Obligation		1,253

This would be the retirement company's journal entry, but for Johnson and Johnson they would only record it all combined as a debit to pension expense.

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?

On December 31, 2007, the company's retirement plan obligation is valued at $12,002 million dollars. This number represents what they believe that they will have to pay out to retired employees in pension benefits. This number is as reliable as they can make it, but they cannot ascertain this number because of the many variables previously mentioned, such as life expectancy and expected years of service, and more.

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 dollars. The average interest rate used to calculate this number would be the beginning PBO balance ($11,660) * interest rate = 656 million. So, if you divide 656/11,660 = .0563. This means the interest rate used to calculate the interest cost is 5.63 percent, and it is a reasonable rate because it is close to a rate previously used in calculating interest.

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

$481 million in pension benefits were paid to retirees during the year. Johnson and Johnson did not pay cash for these benefits, as they were paid out of the retirement pension plan asset fund, which is managed by an independent pension fund company. At some point Johnson and Johnson did pay cash to open the pension fund plan asset account, but they did not immediately pay the benefits to the retirees in 2017. The benefits paid decreased both the retirement plan obligation and the retirement plan asset accounts.

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

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

The value at December 31, 2007 of the retirement plan assets held by Johnson & Johnson's retirement plan is $10,469 million. This value is the fair value of the assets, and it represents the amount of money that future retirees will be drawing from through their pension plan.

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

Expected return on plan assets in 2006 and 2007 were $701 and $809 million respectively, while the actual returns were $966 and $743. These differences are not significant in 2006, but pretty significant in 2007, but it could've been from differences between the market. In my opinion, the actual returns reflect the economics of the company's pension better because it was the amount they were actually earning, rather than the estimate. The estimate limits the volatility between years though so it may be a better method for long term planning.

iii. How much did Johnson & Johnson and their employees contribute to the retirement plan during 2007? How does that compare to contributions in 2006? (See page 63.)

During 2007 Johnson & Johnson and their employees contributed $379 million to the retirement plan. In 2006, they contributed $306 million to the retirement plan.

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

Johnson & Johnson utilizes equity and debt securities.

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

At both year ends their retirement plan is underfunded. It appears under the employee- related obligations section of the balance sheet.

Case #11: A Response to “On the Balance Sheet- Based Model of Financial Reporting”

Case #11: A Response to “On the Balance Sheet- Based Model of Financial Reporting”

Case Summary and Introduction:

This case was about the balance sheet- based model of financial reporting and the pitfalls this currently creates, as well as offering possible discussion points in coming to a new solution. In this case study, we thoroughly read an article from the Columbia Business School and Center for Excellence in Accounting and Security Analysis titled “On the Balance Sheet- Based Model of Financial Reporting”. It addressed the historical impact of the FASB on standardized accounting and how we as accountants arrived at a balance sheet- based financial reporting rather than the income statement- based financial reporting, even when the income statement may seem to have more external value. This article discussed where the balance sheet method falls short, as well as GAAP standards put in place to improve accounting numbers and processes, that have actually led to more volatility within the accounting world, such as fair value accounting and mark to model accounting. This article was an interesting read and presented several discussion points and potential solutions to the problems that have arisen from the balance sheet – based model of financial reporting.

Through this case study I learned a lot about FASB, the balance sheet- based model of financial reporting, the income statement– based model, as well as the differences between the two. I had never previously thought about why we do things the way we do, or even why we approach the balance sheet accounts with such diligence within the accounting curriculum. It was interesting to read such passionate thoughts from people who have experience in the field and have seen first-hand where this model of financial reporting fails businesses and investors. Income statement based financial reporting makes sense to me because at the core of that method is revenues and expenses and matching them, and overall just making income, which is also the same goal of every business. I learned a lot about financial reporting and how it affects everyone not just accountants, which was also something I had never previously thought about as well.

1) "On the Balance Sheet- Based Model of Financial Reporting" Paper Summary

Currently, the FASB and the IASB are meeting together to codify some of their standards so that they agree more, as well as, establish more uniform standards for the industry. Right now, they are elevating the balance sheet as the best way to account for firm success, and the reference point for people to look to, to decide if a firm is performing as it should be. This wasn't the way it always was though, because before the FASB began setting uniform standards in the 1970's, they focused more upon income statement accounting as they were more focused on the business process, and ultimately a firm's income. Now, however, it is becoming more and more unclear if the balance sheet based model of accounting is the best option. The balance sheet orientation places higher emphasis on assets, liabilities, and equities in determining value, which is becoming increasing difficult as more methods are being utilized such as fair value and mark to market. They have moved further from recognizing income and earnings and begun focusing more on the assets. This would make sense, but most businesses use the majority of their assets internally to produce income. Therefore, their assets don't have the same external value as they do internally, leading to volatility in reporting. On the other hand, Income Statement based reporting is more natural, as it focuses on the very thing that firms focus on, which is producing revenues. Investors and others consider earnings vital to deciding a firm's value, so the paper argues that it is logical for an accounting method to do the same. Since the focus is more on balance sheet activities in financial reporting, there has been increased market volatility which affects assets being measured by the fair market value approach leading to greater volatility overall, which is affecting investors estimates on projected earnings. This volatility is making it harder for regular people investing in companies, allowing professionals an upper hand, which is ironic as many of these standards set by the FASB and SEC were made to avoid this such problem. Lastly the paper addressed some possible solutions, recognizing that this was a growing problem and would take time and thought to decide what to do, as this paper was meant to spark a debate, not solve the issue at hand. Possible solutions to be further discussed that they suggested were using multiple bottom lines, further separating operating and financing activities in financial reporting, and lastly making the matching principle the cornerstone of financial reporting, because it already a cornerstone in the way businesses operate.

2) How did reading this article change your current way of thinking?

This article affected my current way of thinking. I have never really previously considered that as accountants we were more balance sheet orientated in financial reporting as compared to income statement. As a student who goes through business education, we learn about all aspects of the business as well. Especially, as a finance minor, we look more specifically at estimable numbers for the future, especially numbers related to the income statement and future earnings. In accountancy classes thus far, we utilize textbook problems looking at how whatever concept we are currently learning is accounted for, and why we account for it. Since we haven't actually entered the professional accounting world, we haven't audited any clients or really looked at the accounting process and production of financials for a single client. However, even reflecting upon my accounting education thus far, much of what we learn and focus on are journal entries, theories, and concepts related to accounts on the balance sheet. We started with assets, which according to this journal article is what the FASB is most focused on as a starting point. The article states that an asset is “something which brings future ‘benefits’, and the implied meaning here is net benefits”, forming that this was the best starting point as of something is producing income there has to be some kind of asset related in producing it, which is a way of thinking about income from an asset point of view, which I had not thought about before.

Before reading this journal article, I had never considered that the balance sheet and income statement sheet almost rivaled each other in terms of financial reporting, rather than just being complementary as I had always assumed. I had no idea that the guiding principles were different depending on the method selected for reporting, and have slightly different goals in the process. The income statement approach is governed more by the revenue recognition principle and the matching expenses to revenues principle, whereas the balance sheet approach is valued by the proper valuation of assets and liabilities as the primary goal, keeping other accounting variables and processes less important. While these concepts were not relatively new, I had not previously viewed them as two complete and separate processes in a hierarchical structure that values one over another, like the FASB does valuing the balance sheet method of financial reporting superior as compared to the income statement. The FASB cited reasons like “conceptual superiority” as the reason for their election of choosing this method, but as financial markets, trading, and the world have continued to move forward, even balance sheet accounts are at odds in the ways they used to be accounted for, and the standards are continually evolving to account for this. This affects the way I think and view certain things because I didn’t know accounting before the fair value principle was in effect, so it is interesting to see the authors of this journal article talk about how the fair value approach is essentially contradicting their reason for choosing the balance sheet method of financial reporting. Furthermore, I learned that the volatility in the markets greatly affects earnings in a period, yet has very little effect on cash flows, causing current earning to tell investors less about future earnings than ever before. I hadn't thought about market making great fluctuations, but because of asset accounts being valued by the market these volatile shifts in the market are being more dramatized leading to numbers that are not reflecting what they are being displayed as. This could become a greater problem into the future, as one reason accountancy and GAAP are of such great importance is because they confirm that the numbers being publicized are correct, as well as providing data for inventors to make informed decisions upon. As this data is becoming less reliable to make future predictions off of, investors have, and will continue to, move to non-GAAP metrics of value. This is a danger to my future, as I am just getting started in the accounting industry and would obviously not want to see any work I do become irrelevant to the outside world. As I enter the industry, I hope to take this new-found knowledge to make sure numbers being reported and adjusted are accurately reflecting what is going on in the business, as well as make sure that even as accountants we are thinking about the long-term effect and longevity of our careers as well.

3) 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.

This information will impact my future career in many different ways. A someone who hopes to enter the public accounting field within the next couple years, it is very interesting to see how standards and accounting approaches are constantly changing and developing. Before the 1970's when there was no uniform approach and some were utilizing the income statement- based model of financial reporting, they had to learn and adjust to the new standardized balance sheet-based model of financial reporting to stay current and informed in their audits and planning. Now many years later, as balance sheet- based accounting has remained constant, there are different problems and inconsistencies being recognized in the field. While my current reality includes balance sheet- based reporting and fair market value estimates, there is no guarantee that this will remain constant in the future, and I should be knowledgeable and adaptable to the changes as they come.

As a future auditor, I know some of what I will do will be focusing on their routine journal entries and checking that numbers are correct and that things are being accounted for correctly. Some of the things that we will check will be related to asset accounts, verifying that inventories, cash accounts are correct, and less of our work will be focused on the income statement as the current thought in the accounting world is that the income statement flows to and through the balance sheet. This process leads to dutiful checking and confirmation that the correct numbers are being presented to users of financial statements, but leads to a problem that is slightly overlooked in that most investors and users of financial information are not primarily looking at the balance sheet, but rather the income statement. This can help my future career as businesses and firms are so often looking to gain the competitive edge and what can set them apart from other businesses, and I think offering financial reporting services that are more income statement based in addition to the services already being provided could set apart a firm from many others.

Lastly, a way I believe this new knowledge could impact my beliefs and future job is knowing that even amongst the accounting profession there are disagreements about the proper way in which things should be accounted for and presented to consumers. I had never before realized that there wasn’t a consensus amongst the professionals and FASB on the GAAP standards, so knowing that there are people who are some of the smartest in the field in disagreement, shows that this isn’t an exact science at all times and just because something is the standard way to do things, be prepared to do extra measures to confirm thoughts, numbers, etc. Especially if I ever decide to get involved in trading securities or stocks, this article confirmed that non- GAAP measures are growing greater in importance in determining whether something is a viable option. This article was an interesting read and addressed issues in accounting that I had previously not even known to exist.

Case #12: Google Inc. – Earnings Announcements and Information Environment

Case #12: Google Inc. – Earnings Announcements and Information Environment

Case Description and Introduction:

This case looked at press releases, reconciling financial numbers between GAAP and non- GAAP, and how all of this information impacts their stock value. All publicly traded companies are required to report GAAP measures, but increasingly companies have begun reporting non- GAAP numbers like EBITDA, EBIT, and other similar metrics. Companies have begun also reporting these secondary measures simply because the GAAP regulated numbers do not allow for much manipulation of numbers, and require everything to be included in their statements. In this case, Google reported non- GAAP measures that were similar to their official GAAP numbers except that they excluded one time charges, stock based compensation expense, and the resulting tax effects of these items. Companies like Google perform these measures because they believe that they lead to more consistent numbers that look at the core of the business, rather than being affected by one time transactions. This case also examined press releases and their resulting effect. It was interesting to see how large of an impact that these releases have on a company's stock performance, and how the information they choose to include in a press release can affect the market's overall reaction to a company's performance.

This case was very interesting, and I learned a lot about accounting measures that I generally do not think of in relation to accounting often. I learned the importance of press releases, especially looking at the timing, and how it affects a company's stock performance. I had also never considered why a company may release non- GAAP numbers with their GAAP statement and the impact these auxiliary numbers may have on an investor's or management's view on the company's performance. It was also interesting looking at how companies can sometimes manipulate these non- GAAP financials to turn negative earnings into profits, so it's important when you look at non-GAAP numbers that you consider how they calculated such numbers before comparing amongst companies.

H. 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.

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

The differences between GAAP measures and non- GAAP measures can be explained through careful examination of the financial statements. Specifically, the differences between GAAP net income and the non- GAAP equivalent can be explained by the exclusion of certain one-time expenses, stock based compensation charges, the tax effects of the excluded charges, one time structuring charges, and lastly the elimination of a net loss from a discontinued business. The largest amount excluded to come to the non- GAAP number is the stock based compensation expenses, or SBC for short. Google's reason in excluding the SBC expense is that is a non- cash expense and is not indicative of their core operations and performance, and providing a non- GAAP measure that excludes stock based compensation expense allows investors and others to more accurately compare their business to others and more easily allow management to compare business between quarters. I agree with most of Google's adjustments in computing non-GAAP earnings. The entire purpose of computing non- GAAP earnings is to evaluate what is actually impacting the core processes of the business, rather than have numbers affected by one time losses and gains. While this is also good for management to compare, according to research it actually doesn't make it any more comparable for outside investors when comparing companies. Also, the SBC expense is rather large, and while it is a non- cash expense, it is one that they carry yearly, and it does recur, so to exclude such a large amount just because it is a non- cash based expense seems like a measure conducted purely for the purpose to make earnings seem larger.

I. Use the attached stock-market charts for Google for 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.

Google's stock overall trended upward in 2013 and performed at a higher level than the NASDAQ comparison. It started the year in quarter one being valued at $707, and finished the year in quarter four being valued at $1,120. Meanwhile, their GAAP consolidated net income in the fourth quarter of 2013 was $3.38 billion compared to 2.89 billion at the end of the 2012. Their EPS grew from $8.62 in the fourth quarter of 2012 to $9.90 in the fourth quarter in 2013. In all reported measures, Google's earnings increased from 2012 to 2013, so their growing stock price matches the company's growing earnings as well.

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

For pretty much the entire year, except for a small dip in late January/ early February, Google outperformed the broader set of firms trading on the NASDAQ exchange. This means Google was trading at a higher level and trending upward at a steeper incline, meaning more accelerated growth than the NASDAQ averaged comparatives.

iii. Based on the stock market chart, did the market perceive the earnings news in Google's press release dated January 30, 2014, as "good news" or "bad news"? Note: the press release was made available after the close of trading for the day

It appears that the market perceived the earnings news as good news, as if you look closely right before the February line you can see a sharp uptick in the market price of the stock, which would allude to the market reacting positively to Google's press release earnings.

J. 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? Are these relations consistent with the positive stock market reaction following the press release?

Their fourth quarter revenue and earnings were less than the analyst forecasts at the time of the earning press release. Analysts had predicted $12.20 earnings per share, and Google reported $12.01 per share in earnings. These results are not consistent with the positive stock market reaction, because generally when companies perform worse than what the analysts expect it leads to their stock price dropping in the market, but Google's shares went up 4 percent after-hours, and ultimately ended up 2.6 percent higher at the end of the next day.

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

Google's stock likely had a positive reaction in the market because of other factors that Google released in their press release. A big factor that excited many investors was Google selling off their smartphone unit to Lenovo. They had absorbed over two billion dollars in operation losses in their smartphone unit since acquiring it, so many investors were excited to see them sell the unit to focus again on what it does best. They also saw more click revenue numbers, which most likely excited investors as it signified that as the businesses were moving more towards mobile ads and development, google was still going to be a relevant way for people to search. The investors were likely led to believe that the value in their stock was more significant than just what the revenue numbers produced this period. Stock price is ultimately the present value of future earnings, so investors likely recognized that their future earnings would increase which ultimately led to Google experience a positive reaction in the stock market after their press release.

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Case 1

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Case 4

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Case 11

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HONOR STATEMENT

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

Signed ________________________