Case Studies of Accounting Concepts and Principles

Jones Albritton
Case Studies of Accounting Concepts and Principles

By
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Approved by

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Reader: Dr. W. Mark Wilder
ABSTRACT
SAM JONES ALBRITTON IV: Case Studies of Accounting Concepts and Principles
(Under the Direction of Victoria Dickinson)

The following thesis contains solutions to case studies performed on various accounting standards in accordance with Generally Accepted Accounting Principles, GAAP. Each case study focuses on a different area of financial reporting with some focusing on the principles and others on the documentation. The case studies were done in conjunction with topics learned during the Intermediate Financial Accounting class. The thesis shows understanding of accounting and financial reporting principles as well as current accounting topics in accordance with GAAP. The case studies were performed under the guidance of Victoria Dickinson and the Patterson School of Accounting in the Accy 420 course during the 2018 to 2019 school year.
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Case 1

Data Analytic Tools

Jones Albritton

Accy 420
Introduction:

This case is about the effects of data analytics tools on the accounting profession. For this case, I had the data analytics tool Domo. Data analytics has become a growing field in the business world with its ability to break down large data sets in small amounts of time. This ability to break down large data sets into figures that can be easily digested and understood by the business world has helped businesses discover useful information, make informed conclusions, and support decision making in a way that has not been available before. Data analytics does all of this through the use of software and specialized systems that comb, scrub, and combine data from many different locations and sources to come up with graphics that are useful to business decisions.

During this case, I learned about the application of data analytics in the accounting profession. I learned that the right use of a data analytics tool like Domo in the processes of audit and tax calculations for a company could mean saving countless hours of work, and more importantly it can lead to more informed decisions and interpretations of data. This can be very useful to the accounting profession because it enables accountants to have a better grasp of what a company has going on, and what it should do for the future through the use of the data analytics tools.
A. What is the history and purpose of this tool and describe, in general, how it is used to make business decisions?

i. Domo was founded in 2010 by Josh James. Domo was called Shacho, Inc. until after the acquisition of Lindon-based Corda Technologies, to help with the data visualization component of his product, Corda changed the name to Domo which means thanks in Japanese. Domo was listed on the NASDAQ Global Exchange June 29, 2018 with an initial stock selling price of $21.00 per share. Domo is a cloud based operating system that has the ability to plug in and pull data from anywhere and make it readable for any type of user from inexperienced to the most advanced. Domo has the ability to share data to multiple devices in real time to help companies share, create, and collaborate on decisions. It also has automated intelligence capabilities that can actually learn and help predict and find the trends for a company. In a business setting, Domo can analyze the data of the company and produce charts on things like efficiency and inventory turnover. Businesses rely on Domo to cut down on their internal overhead costs because of its ability to quickly build and deploy dashboards.

B. How specifically would you use Domo in the following business settings?

i. Auditing

   a. Internal control One of the biggest parts of the audit is looking at a company’s internal control. This is done to make sure that the rules and procedures implemented by a company to insure the integrity of the financial and accounting statements are working properly.
and no fraudulent activities are going on. Domo can help aide the process of the internal control of a company. For example, a company has executives that have been conspiring to commit fraud by misrepresenting their net income through recognizing revenue before it has been earned. Domo in this situation with its ability to plug into the system of the company and sift through all the data in the company in a much shorter time than an auditor could can recognize and analyze the receipts of sales of the company. Then it can pull from the receipts the ones that have been recognized as revenue with dates that are after the year end, which in turn shows the auditors the lack of internal control on the part of the company.

b. *Anticipate future returns* Domo also has the ability to analyze data and recognize trends that can be used to predict what will happen in the future for a company. For example, during the audit of a company the company wants to know the likelihood of future returns for its different product lines. Domo has the ability to do this through its automated learning and trend analysis. Domo can break down the different product lines by connecting to the company’s database. Then it can look at the trend of inventory returns on years past. Finally, Domo would compare these results to the overall market of each line and create a chart that shows which products are more likely to be returned.
c. _Over time analysis_ During an audit the auditors want to know if the numbers are reasonable on the financial statements. Domo can help this process be much less tedious and time consuming for the auditor through trend analysis. Domo can look at the financial statements of the company in years past as a result of being plugged into the data network of the company. Then Domo can break the numbers down to show the trend of each individual item on the financial statements. The auditors can use these trends that domo has given them to crosscheck the current year’s financial statements to the trends of years past to make sure that the numbers on the current statement make sense. That is that the numbers don’t deviate too far from the trends in years past, and if they do see that there is a reasonable explanation for the deviation from the trends.

ii. Tax

a. _Minimize tax rates_ When companies hire an accounting professional to help with their tax preparations they believe that they will get expertise that will help them pay the minimum tax rates that are legal. Domo can help tax accountants to achieve this goal for the companies through its analysis of the tax markets. Most large companies are multinational, and therefore the tax professional has to understand multinational tax laws and rates. Domo can be used to understand and analyze the multinational tax rates and laws to help organize the firm. Through Domo’s analysis
the tax accountant can advise the firm on the actions needed to minimize the tax rates and therefore help the firm pay the least amount in taxes in a year.

b. *Income prediction*  An important part of the tax accountant’s job is to be able to accurately estimate the amount of taxable income for company. Domo can help make this estimate more precise and accurate. For example, a toy company has a last minute huge year-end sale as a result of black Friday and the holidays that produces massive profits. In this scenario, Domo can be used to help the tax accountant know the exact amount of the taxable income from that sale. Domo using its real-time data would give the tax accountant live updates of the effect of this large year end sale on the taxable income, which leads to more effective prediction of a company’s tax bracket and tax rates.

c. *Expansion opportunities*  Companies are constantly looking at where the best opportunities for growth are within their company. They want to know what department to expand, and where to expand. Domo can help a company do this using its ability to push any data site into one and analyze with real-time updates. For example, a company wants to know which one of its brands to expand, and which are to put the plant for the expansion item. Domo can pull the profits from all the brands, analyze them, and give an answer on which one is producing the most profits. Domo
goes a step further by also analyzing the tax rates in the areas where the top brand sells the most product, and recommends the right place for the new plant for the product to be that will maximize the profits while minimizing the tax rates. All of this is done in real-time and is updated constantly with new data Domo is constantly combing through to find the best result.

C. Why should my future accounting partner invest in the acquisition of and training on Domo? Explain how Domo will impact the staffing and scope of my future engagements.

i. Domo as a company has so much potential in the future of business analytics. It is on the cutting edge when it comes to its ability to pull data from any source whether it be a business journal or Instagram and anywhere in between. Also, its ability to cut down on the need for massive amount of business meeting to share data can be invaluable. Everyone in the office can see everything in real-time, and communicate about it from anywhere using Domo’s cloud based operating system. The partner that is in the home office can be in communication and up to date with what the accountants in the field are finding in their audit of the company. All of this would lead to greater productivity in the office, and more transparency between all members of the accounting of each project that the company has going on at the specific moment. As a result of all of this access to data and automated intelligence that is built into the Domo applications, the need for a multitude of auditors in the field for one project would be
unnecessary. Also, travel expenses for accountants would be cut down as a result of being able to see the accounts and workings of businesses from a computer in an office even thousands of miles away. This means in the future there could be almost no need to go out to each company and collect all the data for audits and tax preparations. All that an accountant would need is for the company to give Domo permission to access their business information and the accountant at their desk could analyze and break down all the information without leaving their office.
Case 2

Rocky Mountain Chocolate Factory Excel Accounting

Jones Albritton

Accy 420
Introduction:

In this case, I looked at the financials of Rocky Mountain Chocolate Factory. I was asked to perform the accounting entries for the company for the year. I was asked to make journal entries for the ten items that happened in the current year. Next, I made the applicable adjusting entries for the company based on the entries they made during the year. Finally, I prepared the closing entries so that the company could then prepare their financial statements. I then prepared the incomes statements and balance sheet for the company.

In this case, I learned how to better use excel in a business sense. Coming into this case, I had only used excel to make simple graphs for science classes so this expanded my knowledge of excel. Some of the accounts I expected to see were inventory, cost of goods sold, sales, expense accounts, cash, and the usual asset and liability accounts. I would expect the major asset account to be inventory and the major liability account to be accounts payable. The adjusting entries I expect to see are adjustments to inventory, sales, and depreciation. These adjustments will account for inventory on hand, sales recognized but not received money for, and depreciation of the chocolate making equipment.

Part 1:
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<td>1. Beginning Balance, Feb. 28, 2009</td>
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<td>2. Purchase Inventory</td>
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<td>3. Prepaid Factory for cash and non-cash</td>
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<td>5. Salaries Receivable</td>
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<td>6. Pay for inventory</td>
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<td>7. Sale of Receivable for credit only</td>
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<td>8. Receive franchise fee</td>
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<td>11. Adjust for inventory count</td>
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<td>12. Adjust for inventory count</td>
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<td>13. Record depreciation</td>
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<td>14. Retained Earnings</td>
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</tbody>
</table>

**Pre-closing trial balance:**

- Cash and cash equivalents: 4,100,000
- Accounts Receivable: 5,000,000
- Inventories: 4,064,611
- Property and Equipment, net: 5,253,588
- Goodwill, net: 1,066,646
- Other: 91,027
- Accounts Payable: 5,074,643
- Accrued Salaries and Wages: 423,789
- Long-term Payable: 3,000,000
- Deferred Income Taxes: 142,000
- Common Stock: 1,196,946
- Additional Paid-in Capital: 7,311,280
- Retained Earnings: 5,752,017

**Sales:** 0.00
**Franchise and Royalty fees:** 0.00
**Cost of Sales:** 499,766
**Salaries and Wages:** 1,585,451
**General Administrative:** 2,044,569
**Retail/Operating:** 1,700,000
**Depreciation and Amortization:** 0.00
**Interest Income:** (27,210)

**Income Tax Expense:** 2,090,468

**A = L + OE + R - E**
Part 2

Rocky Mountain Chocolate Factory, INC
Statement of Income, Year End Feb 28, 2010

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

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

| **Operating Income**          | 5,643,335.00     |

<table>
<thead>
<tr>
<th><strong>Other Income (Expense)</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest expense</td>
<td></td>
</tr>
<tr>
<td>Interest Income</td>
<td>27,210.00</td>
</tr>
<tr>
<td>Other, net</td>
<td>27,210.00</td>
</tr>
</tbody>
</table>

<p>| <strong>Income Before Income Tax</strong>  | 5,670,545.00     |
| <strong>Income Tax Expense</strong>        | 2,090,468.00     |
| <strong>Net Income</strong>                | 3,580,077.00     |
| <strong>Basic Earnings per Common Share</strong> | 0.60            |
| <strong>Diluted Earnings per Common Share</strong> | 0.58        |
| <strong>Weighted Average Common Shares Outstanding</strong> | 6,012,717.00   |
| <strong>Dilutive Effect of Employee Stock Options</strong> | 197,521.00  |
| <strong>Weighted Average Common Shares Outstanding, Assuming Dilution</strong> | 6,210,238.00 |</p>
<table>
<thead>
<tr>
<th>Assets</th>
<th>Amount (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Cash and cash Equivalents</td>
<td>3,743,092.00</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>4,427,526.00</td>
</tr>
<tr>
<td>Notes Receivable, current</td>
<td>91,059.00</td>
</tr>
<tr>
<td>Inventories</td>
<td>3,281,447.00</td>
</tr>
<tr>
<td>Deferred Income Taxes</td>
<td>461,249.00</td>
</tr>
<tr>
<td>Other</td>
<td>220,163.00</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td>12,224,536.00</td>
</tr>
<tr>
<td><strong>Property and Equipment, Net</strong></td>
<td>5,186,709.00</td>
</tr>
<tr>
<td><strong>Other Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Notes Receivable, less current portion</td>
<td>263,650.00</td>
</tr>
<tr>
<td>Goodwill, net</td>
<td>1,046,944.00</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>110,025.00</td>
</tr>
<tr>
<td>Other</td>
<td>88,050.00</td>
</tr>
<tr>
<td><strong>Total other assets</strong></td>
<td>1,508,669.00</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>18,919,914.00</td>
</tr>
</tbody>
</table>

| Liabilities and Stockholders’ Equity       |              |
| Current Liabilities                        |              |
| Accounts Payable                           | 877,832.00   |
| Accrued Salaries and Wages                 | 646,156.00   |
| Other Accrued Expenses                     | 946,528.00   |
| Dividend Payable                           | 602,694.00   |
| Deferred Income                            | 220,938.00   |
| **Total current liabilities**              | 3,294,148.00 |
| **Deferred Income Taxes**                  | 894,429.00   |

| Commitments and Contingencies              |              |
| Stockholders’ Equity                       |              |
| Common Stock                               | 180,808.00   |
| Additional Paid-in Capital                 | 7,626,602.00  |
| Retained Earnings                          | 6,923,927.00 |
| **Total stockholders’ equity**            | 14,731,337.00|
| **Total liabilities and stockholders’ equity** | 18,919,914.00|
## Part 3

### Cash Flows

<table>
<thead>
<tr>
<th>Transaction Number</th>
<th>Cash Flow Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>operating</td>
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<tr>
<td>2</td>
<td>operating</td>
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<tr>
<td>3</td>
<td>operating</td>
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<td>operating</td>
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<td>operating</td>
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<td>6</td>
<td>operating</td>
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<td>7</td>
<td>operating</td>
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<tr>
<td>8</td>
<td>operating</td>
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<tr>
<td>9</td>
<td>investing</td>
</tr>
<tr>
<td>10</td>
<td>financing</td>
</tr>
</tbody>
</table>
Case 3

Accounting Discussion Scenarios

Jones Albritton

Accy 420
Introduction:

In this case, we were asked to discuss with our classmates the validity of different arguments of students. Dr. Dickenson would read the first select some people in the class to act out the scenario. Then, the students would read through the entire scenario that had to do with some aspect of the accounting school. The discussions centered around the difficult decision that a student faces while in the accounting school. This difficult decision had to do with academics and recruiting for internships, which are two of the most important aspects of an accounting student’s time. We then decided if the conclusions made were acceptable or not. We based these conclusions on our own experiences as well as advise that we had received from other students who had already been through the processes.

During this case, I learned the importance of being well informed before you make a decision about your future especially coming out of the accounting school. I think one of the most impactful things that I heard was the amount of money the firms actually spend to get us through the recruiting and internship process. Hearing that a firm will be putting $175,000 into me before they even hire me makes me have a better understanding of the serious and respectfulness that is needed at all stages of the accounting recruiting cycle. Also, the advice of visiting cities I am thinking about interning and living in was important to hear. It was great advice hearing that I should explore the rents and all other aspects of the city before I commit to that city.
A. Scenario one was two students talking about what they wanted to do as accounting majors. One student was adamant about going to law school right out of college, but still doing the senior accounting internship. He was set on this because he could earn more money as a tax lawyer. The other student suggested that a master in tax from the accounting school would be sufficient instead of having to go to law school. In this scenario, I sided with the first student who wanted to go to law school. I believe that business in this time is becoming more specialized, so getting a very specialized law degree would help the student to excel earlier in his career. Every company needs a lawyer and an accountant so in that sense he is also setting himself up to have many options in the long run with his career. Also, going to law school for tax law would give a person more tax knowledge than just getting their masters in tax from the accounting school. Ole Miss even offers a program where you can get your master in accounting and your JD in 3 years, which would merge what both people in this situation were saying.

B. Scenario two was about three students who were accounting majors, but none of them wanted to be in the accounting profession for more than two years. The first student wanted to use their degree to become an investment banker after doing an accounting internship in New York City. The second student wanted to use the degree and two years in public accounting to get into a good MBA school to become a consultant and travel the world doing work similar to what is done in the case competitions. The third student wanted to go into the financial or consulting field with their accounting degree. In this scenario, I decided that all of
these students have valid arguments. My only reservation with these three
students is that if they plan to do all of this they should be up front with the
accounting firms on what their long-term plans are especially with the amount of
money the accounting firms are putting into the recruitment and training of them.
Accounting is the language of business so I don’t have a problem with good
students wanting to get the best degree possible for what they want to accomplish
in life. At the end of the day people have to make decisions that are best for them,
and this seems like a case of that. Also, firms if you are open and honest with
them will help you get placements in different footings that you want, especially
if you perform at a high level.

C. Scenario three was a student emailing Dr. D and asking for her advice on how to
approach asking a firm to let them transfer from one city to another. This email is
occurring at the end of the student’s masters in accounting year. The student says
that D.C. was fine as an internship and that they loved their time there, but wanted
to be in Dallas long-term. The student wanted some advice on how to go about
asking the firm to transfer them from D.C. to Dallas. Dr. D gave the student
advice, and stated that it could be hard to secure this transfer. I decided that I
don’t agree with the reasoning behind the student wanting to transfer. If you fit
well with the staff and just don’t like the city after only being there for a few
months then I don’t think you gave the city enough time to really get to know it. I
think it is great to ask someone like Dr. D or any other person with knowledge of
these situations for advice. The D.C. office has spent a ton of time and money to
get this student ready for the accounting world, and I think the best thing to do would be for the student to stick it out in D.C. I think the student could ask the D.C office for a transfer in two or three years once they have gotten their value back from the process of training the student. In the long run the student can still be in Dallas even if it takes three years to actually get the transfer down there. I feel it is disrespectful for the student to ask for a transfer at this point when they are about to graduate from graduate school and start work.
Case 4

Generic Bank Impairment Loss

Jones Albritton

Accy 420
**Introduction:**

This case was about securities and their classification for financial statements. In this case, we were asked to look at the financial statements and available for sale securities of Generic Bank. We were then asked to decide if Generic Bank had impairment losses on securities based on information given to us and accounting standards. Securities that are sold at a loss meaning their fair value is less than their amortized cost over a period of time. What makes the loss impaired is when either the security loses value due to credit or the institution does not have the ability and intent to hold the security until its value returns to the amortized cost. In the case, we were also asked to look at Generic Bank’s decision from the perspective of various people including an executive in the bank, an external auditor, and a bank regulator.

I learned that if you are dealing with a bank then you must have the smallest microscope when looking at the financials of the bank. This is because the bank regulator is the one who has the power to continue to keep the bank operational or shut it down for a lack of ability to maintain the proper capital ratios. Also, I learned that when dealing with impairment loss the application of the rules are not always black and white. My assumptions based on the rules can be correct, and another person who reads the same information can come up with a different assumption that can be backed up and seen as correct. I believe this case has been a good example of showing that accounting, although it is billed as being a boring and black and white profession, is actually a profession that requires a large amount of critical reasoning and thinking.
Question 1:

Yes, the loss should be counted as an impairment loss on 20x2. This is because the loss is material. Also, the net fair value of selling the seven securities is less the amortized cost of the seven securities, which is the definition of an impairment loss. ASC 326-30 says that for a loss to not be an impairment loss the company must have “the intent and the ability to hold the security”. Winter stated that he was worried about the effects of selling these seven securities at the end of year 20x2 so they had no intent of holding the securities at the end of 20x2. This means that the impairment loss should be recognized for the year 20x2 not 20x3 when they sold the securities.

Question 2:

No, Generic Bank does not have an impairment loss on any of the other securities other than the seven sold. ASC 326-30 states that the two situations where a loss is an impairment loss is if there is an indication that bondholders will not make future payments, which is not stated in the article, or that the company does not have the intent or ability to hold the securities in the future. The bank is said to have the intent and ability to hold the other securities. It says that the liquidity of those seven securities was “purely voluntary”, and that they have plenty of capital and liquidity ability other than selling the securities.

Questions 3:

If I am looking at the bank from the role of the external auditor then yes, my answer to the second question does change. The fact that all the securities are marked
AFS by the bank suggests that they do not intend to hold the securities for a long period of time. They do not have the intent to let them try and recover from their loss position because if they did then they would not be marked as AFS. The sixty percent of securities that have been in a loss position for over a year gives me reasonable doubt that they can recover from the loss. As the external auditor, I would have to say that the sixty percent of the AFS securities that have been in a loss for over a year should be considered impairment losses. This comes down to the fact that their value has not bounced back up, and they are available for sale and therefore the bank has no intent to keep them until they do recover from their loss position. From the viewpoint of the bank regulator the losses would also be considered impairment. Footnote 4 says that the bank regulator is in charge of “keeping the stability of the banking system”, which is even more important in this case than the external auditor. The bank regulator needs to be even more scrutinizing of the data because he is in charge of providing charters to banks on the basis that they are of sound financial standings. With this definition in mind, the bank regulator would want additional information on the finances of the company like their liquidity ratios, along with the effect of the losses on the liquidity ratios. The bank regulator needs this information to know if a bank should remain operational or be shut down as a result of bad capital ratios. On the side of the auditor, something of value that would be helpful would be the credit scores of the securities issuers so we can estimate if there is a credit loss on the securities as stated in ASC 326-30. If there was a credit loss we can assume right away that the loss on the securities are impairment losses.
**Question 4:**

In the case of the securities being sold for a net gain in question one and two then you would go through and look at each individual security to see if it was sold for a gain or loss. If the security was sold for a gain, then the security would not be registered as an impairment because gains cannot be an impairment. In the case of the seven securities that were sold, two of the securities were sold for a gain and those would not be counted for as an impairment loss. The five securities that were sold as a loss would still be counted as an impairment loss. As ASC 326-30 states there must be “intent and ability of a company to hold these unrealized loss debt securities until they can recover to their amortized cost basis”. In this case, even though the net is sold as a gain the five securities that are sold as a loss should still be considered impaired because the bank did not have the intent to hold the unrealized loss debt securities until they could recover to their amortized cost basis. If each individual security had been sold in a gain position then none of the seven of the securities would be classified as an impairment loss.

**Question 5:**

If Generic Bank is only adequately capitalized and therefore wanting to sell securities to improve capital ratios and fulfill other borrowing transactions, then Generic Bank does have impairment losses in 20x3 on securities other than the seven securities sold. As a result of other forms of borrowing money becoming limited and their capital ratios decreasing I believe the bank no longer satisfies the “intent and ability to hold the unrealized loss securities until they recover their amortized cost”. Since the bank needs to sell these securities to raise the capital to continue their plan of expanding through
acquisitions then the intent of Generic Bank is to sell these securities not to keep them to recover their cost. This would make all of the securities that Generic Bank plans to sell in 20x3 at a loss into an impairment loss for the company.
Case 5

Internship City Selection

Jones Albritton

Accy 420
Introduction:

In this case, we were asked to look at various questions about our top cities to help aid us in our decision-making process. This case provided a great opportunity to explore what different cities have to offer, and was helpful in a time where the decisions of our future are surrounded in ambiguity. The case asked 16 questions about the specifics and logistics of living in the cities that are the top cities each person is looking to move to out of college.

A. What is the population?

The population of the city of Atlanta is 486,290 and the metro population is 5,789,700 people. The population of Nashville is 691,243 people and the metro population is 1,903,405.

B. Describe the climate and seasonal fluctuations.

Atlanta has a mild climate with temperatures in the summer ranging between mid 80s and low 70s. In the winter the temperature is between the upper 40s and the lower 30s. There is precipitation in Atlanta around 100 days per year, and the humidity is high in the summer. Nashville also has a mild climate with its summer temperature being between 90 degrees and 65 degrees. In the winter, Nashville has average temperatures ranging from high 40s and high 20s.
C. 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.

Atlanta is situated among the foothills of the Appalachian Mountains. Atlanta has one of the highest elevations among major cities east of the Mississippi River. Atlanta sits atop a ridge south of the Chattahoochee River.

Figure 5-1:

Nashville is located on the Cumberland River in the Nashville Basin in Middle Tennessee.

Figure 5-2:
D. What are the individual tax rates within the city?

Atlanta has a marginal tax rate of 6 percent for someone making $50,000, but the effective tax rate would be 5.3 percent. Using that rate plus the federal tax rate and FICA I would be paying $12,112 in taxes per year. Nashville has no state or local income tax rate. Using the federal tax rate and FICA I would pay $9,465 in taxes per year. Nashville does have a sales tax that is 9.25 percent.

E. What transportation hubs are in the city?

Atlanta is home to the Hartsfield-Jackson airport, which is one of the busiest transportation hubs in the world. Nashville is home to the Nashville International Airport, which is the fourth fastest growing airport in the United States. It is a hub for southwest Airlines.

F. What are the city’s most prevalent industries?

Atlanta is home to third most fortune 500 companies in the United States including Delta, Coca-Cola, Home Depot, and many others. Atlanta also is the center for Turner broadcasting network, which owns CNN and TBS. The total economy of Atlanta is top twenty in the world. Nashville is a center for the music industry specifically country music. The guitar company Gibson has its headquarters in Nashville. The city’s largest industry is healthcare with over 300 healthcare companies in the city. The Hospital Corporation of America is the largest healthcare company in the city.
G. Describe the quality of the city’s healthcare?

Georgia and Tennessee as states do not have a great healthcare systems. According to one ranking the state is 45th in healthcare access, and 44th in healthcare quality. Tennessee as a state is 35th in healthcare access, and 40th in healthcare quality.

H. What types of crimes are common within the city and where are the locations in the city to avoid?

Atlanta has been known as a hub for human trafficking with the city being one of the highest for sex trafficking. Also, Atlanta is known for its gang and drug related crimes. According to Trulia’s crime map the key areas to avoid are southwest of I-20 and I-85 interchange. Nashville according to a CBS news article is the 25th most dangerous city. Two of the major crimes in Nashville are murder and burglary.

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

In Atlanta, I would plan on spending between $1,500 and $1,700 a month to live with a roommate. The apartments that I looked at had washers and dryers included as well as parking. These units were around 1000 square feet. My sample property is Briarhill apartments, which are near Midtown.
In Nashville, I would expect to live with a roommate and pay between $1100 and $1300 a month. The apartments that I looked at included a washer and a dryer as well as parking. The units I looked at were around 1000 square feet. The sample property I chose was Pine Street Flats in the Gulch.
J. What is the typical mode of commuting and what are your likely commuting times?

Most people in Atlanta either drive to work or use the MARTA, which is Atlanta’s rapid transit system. My likely commuting time by driving would be around 20 to 30 minutes depending on the traffic, which in Atlanta can be bad. In Nashville, over 90 percent of people commute to work by car. My average drive time would be 10 to 15 minutes depending on the traffic that day.

K. Where will you do your grocery shopping?

I researched that near my apartment that I put as my example in Atlanta there is a Publix and a Target. I would plan on going to either of those to do my grocery shopping. In Nashville, the apartment I put as my example is near Kroger, which is where I would do my grocery shopping.

L. How will you do your laundry?

I will use the washer and dryer in my apartment since all of the apartments I looked at in both cities have built in washers and dryers.

M. Name at least three civic, religious, or charitable organizations you would like to be active in for each city.

In both Atlanta and Nashville, I would join around the same organizations. I would join an Episcopalian Church. I would probably also join the rotary club of either city,
and I would plan on volunteering with Habitat for Humanities and the Boys and Girls club in Atlanta and Nashville.

N. 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.

I am a big sports fan so I would plan on being a fan of the Falcons, Braves, Hawks, and Atlanta FC soccer team. Also, the Georgia dome is usually home to many college football games throughout the season, and plays host to the NCAA Men’s basketball tournament every year. The Georgia dome is a huge concert venue as well so I would try to go to concerts when they come to town. In Nashville, I would plan on going to Titans, Predators, and the new Nashville professional soccer team games. The city of Nashville is known for having great concert venues, and attracting many concerts that I would enjoy going to. I would also enjoy going to Steeplechase in Nashville, which is an annual horse race event held in May.

O. 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?

I’m from Knoxville, TN so my travel home from both Atlanta and Nashville would be by car. The drive from Atlanta to Knoxville is around 3 hours which comes out to 220 miles. The average cost would be around 60 to 70 dollars in gas roundtrip to get home and back depending on gas prices. The drive from Nashville to Knoxville is around 2 hours and 45 minutes, or 180 miles. The average cost would be around 50 to 60 dollars in gas roundtrip depending on gas prices.
P. 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.

**Figure 5-5:** Atlanta, GA

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Income</td>
<td>5000</td>
</tr>
<tr>
<td>Taxes</td>
<td>(1010)</td>
</tr>
<tr>
<td>Rent</td>
<td>(1500)</td>
</tr>
<tr>
<td>Healthcare</td>
<td>(250 )</td>
</tr>
<tr>
<td>Utilities</td>
<td>(170 )</td>
</tr>
<tr>
<td>Savings</td>
<td>(900 )</td>
</tr>
<tr>
<td>Discretionary Income (groceries, gas, dining, etc.)</td>
<td>1170</td>
</tr>
</tbody>
</table>

**Figure 5-6:** Nashville, TN

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Income</td>
<td>5000</td>
</tr>
<tr>
<td>Taxes</td>
<td>(0)</td>
</tr>
<tr>
<td>Rent</td>
<td>(1200)</td>
</tr>
<tr>
<td>Healthcare</td>
<td>(250 )</td>
</tr>
<tr>
<td>Utilities</td>
<td>(185 )</td>
</tr>
<tr>
<td>Savings</td>
<td>(900 )</td>
</tr>
</tbody>
</table>
Q. 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 am still interested in living in both of the cities that I researched. Atlanta before this project was my top choice, and after doing all of this research Atlanta is still my top choice. I think both of my cities have many opportunities to experience life in a fun and interesting way outside of work. I also think that both are cities that are booming with business, and business opportunities. I prefer Atlanta over Nashville because I value the amount of Fortune 500 companies in Atlanta as well as the physical location of Atlanta, which is closer than Nashville to much of my extended family.

**Conclusion:**

I thought this case was unique in the sense that it gave me a more tangible idea of what it would be like to live in these cities that have only been rough thoughts in my head. Atlanta was my top choice before I began this case, and after the case it is still my top choice. With that being said being asked some of these questions made me think more than I ever had about my reasoning to want to move there after college. One of the most interesting things that I hadn’t thought about before this case is the fact that Georgia has an income tax while Tennessee does not. I never realized the effect that this would have on the discretionary income that I would have per month. At the end of this case I can see myself living in either place, but the case did help solidify for me that Atlanta should be my top choice.
Case 6

WorldCom Fraud

Jones Albritton

Accy 420
Introduction:

In this case, we were asked to analyze the effect of WorldCom’s fraudulent accounting practices. WorldCom wrote off some expenses as capital expenditures, which helped them to hit their earnings targets. This action directly misled the stockholders of WorldCom through manipulation earnings. Also, the intentional misstatement led to their net income being stated at a number much higher than it should have been for the year.

This case taught me that even a small action can have a large magnitude. The act of mislabeling some expenses can cause a snowball affect making the financials inaccurate, and therefore misleading investors. I also learned the importance of understanding the proper definition for what should be capitalized and what should be expensed, which can lead to millions of dollars of differences in net income. The importance of this definition is that items that are capitalized get listed as assets on the balance sheet, while expenses get counted against the earnings of the corporation. This case helped teach me that not recording an expense inflates net income, and then recording the expense as capital further inflates the financial position of a company. The combination of these two mistakes can lead to millions of dollars in misstatement amounts. The journal entries in this case are in millions of US dollars.

A.

i. An asset has three essential characteristics: (a) item bodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity' s right to or
control of the benefit has already occurred. Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations. Characteristics of Expenses. Expenses represent actual or expected cash outflows (or the equivalent) that have occurred or will eventuate as a result of the entity's ongoing major or central operations. ii. Costs should be expenses when they maintain the given level of service for the asset. Costs should be capitalized when they incur to achieve greater future benefits for the asset.

B. Costs, when they are capitalized, are debited to the asset account that they correspond to. After they are debited to the asset account the costs are then amortized over time. As a result of capitalizing a cost the value of the asset account on the balance sheet increases, which increases total assets. On the income statement, as a result of capitalizing and not expensing a cost the net income of the company would increase because of the decrease in expenses.

C. $14.739 million was the line cost for the year end December 31, 2001. Line costs are fees WorldCom paid to third party telecommunication network providers in order to access the third parties’ networks.

Line Costs $14.739 million

Accounts Payable $14.739 million

D. The costs that were being improperly capitalized were costs paid to local telephone networks to complete calls. The transactions that give rise to these costs
are when a person calls someone long distance the company has to pay the local networks in the area they are calling to use their network to complete the call for the client. These costs do not meet the definition of an asset in part A because there is no future benefit associated with these costs. The costs were each a one-time payment for the use of the technology of another company to complete a transaction.

E. The costs showed up on the balance sheet under the transmission equipment asset account. They show up on the statement of cash flow in the Capital expenditure account.

Transmission Equipment $3.005 million

Line Costs $3.005 million

F. The depreciation expense is calculated by dividing the quarterly expenditures for the transmission equipment by the life of the equipment. That amount is then multiplied by the fraction of the year it represents.

**Figure 6-1 Depreciation Calculation**

Quarter 1 Expenditures: $771 million / 22 years * 4/4 quarters = $35.045 million
Quarter 2 Expenditures: $610 million / 22 years * 3/4 quarters = $20.795 million
Quarter 3 Expenditures: $743 million / 22 years * 2/4 quarters = $16.886 million
Quarter 4 Expenditures: $931 million / 22 years * 1/4 quarters = $10.580 million

Total Depreciation Expense: $83.306 million

Depreciation Expense $83.306 million

Accumulated Depreciation - Transmission Equipment $83.306 million
G. The difference in the corrected and original net income for WorldCom is material. The original reported net income for WorldCom was $1.5 billion, but this includes many material errors. To correct the net income first the improper capitalization of line costs caused net income to be overstated by $3.055 billion. The next misstate was the overstatement of depreciation expense by $83.306 million. Finally, the income taxes of WorldCom were overstated by $695 million. Once the line costs were subtracted and the depreciation expense and income tax amounts were added back the corrected net loss for WorldCom was $776 million. The difference from the originally stated net income of $1.5 billion and the corrected net loss of $776 million is an overstatement of $2.276 billion, which is a material difference.
Case 7

Starbucks Financial Statements

Jones Albritton

Accy 420
**Introduction:**

This case was about understanding and analyzing financial statements, specifically Starbucks 10-K. I had to analyze what different numbers meant in the different financial statements. This case was about contextualizing the different numbers on the financial statements, and deciding what accounts and numbers were important and which ones did not have much materiality. The skill of contextualizing and breaking down the important accounts in the statements is an important part of the audit for companies. This ability to interpret financial statements is useful for any person because it allows you to better understand how companies make their money and grow their business. However, the 10-K shows more than just the different financial statements it also talks about different reasons on how the company got to their different numbers and what assumptions they made in the footnotes.

I learned from this case the importance of seeing what percent of total revenues is each item on the income statement. By putting all the numbers as percentages of total revenues I could more easily see what the main expenses and revenues were making analyzing the income statement so much easier. I did the same thing for the balance sheet by using total revenues to divide all other number by, and it provided the same advantages. I found it interesting how Starbucks accounted for the customer gift card, and how if they are never redeemed they just put that number into net interest income. I think financial statement analysis is important for everyone to at least have a basic grasp of even if the person isn’t in the business world.

**A.** The nature of Starbucks business is purchasing and roasting high-quality coffees that they sell, along with handcrafted coffee and tea beverages and a variety of
fresh food items, through their company-operated stores. They also sell a variety of coffee and tea products and license their trademarks through other channels such as licensed stores, grocery and national foodservice accounts.

B. The financial statements that are commonly made for financial reporting are the income statement, balance sheet, and cash flow statement. Starbucks calls these the consolidated statement of earnings, the consolidated balance sheet, and the consolidated statement of cash flows. Consolidated financial statements include financial position and operating results from all Starbucks entities, which include wholly owned subsidiaries.

C. Most companies report their financials on a quarterly basis.

D. The CEO and CFO as well as the other executives of the company are responsible for the financial statements. The financial statements can be used by investors or potential investors that are looking to invest in the company. The statements help investors decide if they should continue to keep their money in Starbucks, or if they should invest in Starbucks at all. They are likely interested in the EPS of the company as well as if the company is increasing in revenue and net income from year to year. They could also be interested the capital structure of the company.

E. The external auditor of Starbucks is Deloitte, and the audit is conducted in Seattle, Washington. The first letter is on the importance of disclosure when performing an audit. The second letter is about maintaining adequate internal control for financial reporting for Starbucks. They are dated after the year end because the audit is not finished right at the end of the fiscal year. It takes some time for auditors to perform the audit to the required standard levels. The option was an
unqualified opinion.

F.

Consolidated Statements of Earnings (USD $)
In Millions, except Per Share data, unless otherwise specified

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net revenues:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Company-operated stores</td>
<td>79.19%</td>
<td>79.21%</td>
</tr>
<tr>
<td>Licensed stores</td>
<td>9.14%</td>
<td>9.10%</td>
</tr>
<tr>
<td>CPG, foodservice and other</td>
<td>11.67%</td>
<td>11.69%</td>
</tr>
<tr>
<td>Total net revenues</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
<tr>
<td>Cost of sales including occupancy costs</td>
<td>42.86%</td>
<td>43.71%</td>
</tr>
<tr>
<td>Store operating expenses</td>
<td>28.78%</td>
<td>29.46%</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>3.07%</td>
<td>3.23%</td>
</tr>
<tr>
<td>Depreciation and amortization expenses</td>
<td>4.17%</td>
<td>4.14%</td>
</tr>
<tr>
<td>General and administrative expenses</td>
<td>6.30%</td>
<td>6.02%</td>
</tr>
<tr>
<td>Litigation charge</td>
<td>18.70%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>103.87%</td>
<td>86.57%</td>
</tr>
<tr>
<td>Gain on sale of properties</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Income from equity investees</td>
<td>1.69%</td>
<td>1.58%</td>
</tr>
<tr>
<td>Operating income</td>
<td>-2.19%</td>
<td>15.02%</td>
</tr>
<tr>
<td>Interest income and other, net</td>
<td>0.83%</td>
<td>0.71%</td>
</tr>
<tr>
<td>Interest expense</td>
<td>-0.19%</td>
<td>-0.25%</td>
</tr>
<tr>
<td>Earnings before income taxes</td>
<td>-1.54%</td>
<td>15.48%</td>
</tr>
<tr>
<td>Income taxes</td>
<td>-1.60%</td>
<td>5.07%</td>
</tr>
<tr>
<td>Net earnings including noncontrolling interests</td>
<td>0.06%</td>
<td>10.41%</td>
</tr>
</tbody>
</table>

Net earnings attributable to noncontrolling interest | 0.00% | 0.01%
Net earnings attributable to Starbucks | 0.06% | 10.40%
### Consolidated Balance Sheets (USD $)


**In Millions, unless otherwise specified**

#### Current assets:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>22.36%</td>
<td>14.46%</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>5.71%</td>
<td>10.32%</td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>4.87%</td>
<td>5.91%</td>
</tr>
<tr>
<td>Inventories</td>
<td>9.65%</td>
<td>15.10%</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>2.50%</td>
<td>2.39%</td>
</tr>
<tr>
<td>Deferred income taxes, net</td>
<td>2.41%</td>
<td>2.90%</td>
</tr>
<tr>
<td>Total current assets</td>
<td>47.51%</td>
<td>51.09%</td>
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#### Long-term investments

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term investments</td>
<td>0.51%</td>
<td>1.41%</td>
</tr>
<tr>
<td>Equity and cost investments</td>
<td>4.31%</td>
<td>5.60%</td>
</tr>
<tr>
<td>Property, plant and equipment, net</td>
<td>27.79%</td>
<td>32.35%</td>
</tr>
<tr>
<td>Deferred income taxes, net</td>
<td>8.40%</td>
<td>1.18%</td>
</tr>
<tr>
<td>Other assets</td>
<td>1.61%</td>
<td>1.76%</td>
</tr>
<tr>
<td>Other intangible assets</td>
<td>2.39%</td>
<td>1.75%</td>
</tr>
<tr>
<td>Goodwill</td>
<td>7.49%</td>
<td>4.86%</td>
</tr>
<tr>
<td>TOTAL ASSETS</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

#### Current liabilities:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>4.27%</td>
<td>4.84%</td>
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<tr>
<td>Accrued litigation charge</td>
<td>24.17%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>11.02%</td>
<td>13.79%</td>
</tr>
<tr>
<td>Insurance reserves</td>
<td>1.55%</td>
<td>2.04%</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>5.68%</td>
<td>6.21%</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>46.69%</td>
<td>26.89%</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>11.28%</td>
<td>6.69%</td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td>3.11%</td>
<td>4.20%</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>61.08%</td>
<td>37.77%</td>
</tr>
</tbody>
</table>

#### Shareholders’ equity:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>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</td>
<td>0.01%</td>
<td>0.01%</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>2.45%</td>
<td>0.48%</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>35.86%</td>
<td>61.40%</td>
</tr>
<tr>
<td>Accumulated other comprehensive income</td>
<td>0.58%</td>
<td>0.28%</td>
</tr>
<tr>
<td>Total shareholders’ equity</td>
<td>38.90%</td>
<td>62.16%</td>
</tr>
<tr>
<td>Noncontrolling interests</td>
<td>0.02%</td>
<td>0.07%</td>
</tr>
<tr>
<td>Total equity</td>
<td>38.92%</td>
<td>62.23%</td>
</tr>
<tr>
<td>TOTAL LIABILITIES AND EQUITY</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>
G.

i. Not part of the case study.

ii. Starbucks major assets are Cash and Cash Equivalents, Inventory, and Property, Plant, and Equipment. All of these items seem appropriate because Starbucks needs to have a large inventory of coffee and baked good. As a result of this Starbucks need storage to put this inventory, as well as lots of equipment to brew all the coffee. The percent of short term assets to total assets for Starbucks is 47.51 percent for 2013. The percent of long term assets to total assets for Starbucks is 52.49 percent.

iii. An intangible asset is an asset that is not physical in nature. Goodwill, brand recognition and intellectual property, such as patents, trademarks and copyrights, are all intangible assets. Goodwill is intangible asset associated with the purchase of one company by another. Specifically, goodwill is recorded in a situation in which the purchase price is higher than the sum of the fair value of all identifiable tangible and intangible assets purchased in the acquisition and the liabilities assumed in the process. Starbucks might have trademarks and copyrights on their logo and the different names and brands of their coffee. Also, they could have patents on the brewing machines or brewing techniques that their company uses.

iv. Starbucks is financed 11.28 percent by long-term debt and the rest by their operating income. The portion of total financing that comes from non-owners is .02 percent.
H.

i. Revenue is recognized when payment is tendered at the point of sale. This means Starbucks uses the cash basis of accounting. Revenues from the 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. One of the challenges in recording revenue is estimating when the likeliness of redemption is deemed to be remote since the gift cards never expire.

ii. Starbucks’ major expenses are the cost of sales including occupancy costs, store operation expenses, and in 2013 a litigation charge. The cost of sales expense includes the cost for the company to operate the facilities where it sells items. In this item is labor cost associated with shipping products to people, as well as the labor cost of producing the goods. The store operating expenses includes the cost of items like the food and beverages sold in the stores as well as the employee salaries from the stores. This expense includes all expenses associated with the retail operations of Starbucks.

iii. The only major difference in the cost structure from 2012 to 2013 was the change in reporting certain indirect overhead costs such as merchandising, manufacturing costs and back office shared service costs. Instead of being allocated to segment level costs of sales and operations the indirect overhead costs are now handled at a corporate level by being reported with unallocated corporate costs.

iv. Starbucks included the litigation charge for a lawsuit in the operating
income and not in the line item for general and administrative expenses because it is a substantial one-time expense, and lumping it in would make it harder to understand exactly why the expenses for the company went up. It is a substantial expense, and has a material effect on the net income of the company. It is an operating expense because it relates to part of Starbucks operations since the litigation is for something that happened to Starbucks in operations.

v. In the fiscal year 2013, the company was not profitable in my eyes. In the fiscal year 2012 Starbucks was profitable. My definition of profitable is that Starbucks net revenue is greater than its net expenses. In 2013 Starbucks net revenues are less than its net expenses, while in 2012 Starbucks net income was greater than its net expenses.

I.

i. In 2013 Starbucks net income was 8.3 million while its net cash provided by operating activities was 2908.3 million. The difference in these two numbers is caused by the litigation charge, which in the cash flow statement is added to operating activities, while in the income statement it is subtracted from the revenues. Also, the difference can be attributed to the depreciation and amortization expense, which is added in the cash flow statement and subtracted in the income statement.

ii. In 2013 Starbucks spent 1151.2 million to acquire more property, plant, and equipment.

iii. In 2013 Starbucks declared 668.6 million in cash dividends, and it paid
cash dividends of 628.9 million. Starbucks paid less in cash dividends than it declared, and this is probable due to the fact that Starbucks was not profitable in 2013 due to the litigation charge.

J.

i. Accounts on the balance sheet that are estimates include short term investments, accounts receivable, inventory, long-term investments, property, plant, and equipment, other intangible assets, goodwill, long-term debt, retained earnings, accumulated other comprehensive income. Some accounts on the balance sheet are not estimates, and those accounts are cash and cash equivalents, accounts payable, and common stock.
Case 8
BP Oil Spill

Jones Albritton
Accy 420
Introduction:

This case was about the accounting for a contingent liability that occurs for a company. In this case, the Deepwater Horizon oil spill was the event that took place for BP that led them to have to report a contingent liability. A Contingent liability is reported based on the idea that a future loss will occur and that a reasonable estimate of the cost can be calculated. Also, I was asked to describe some of the potential losses that BP could expect to incur from the oil spill. This was the most interesting part of the case to me. I found it interesting how oil being spilled in the ocean could affect so many different businesses and events on the Gulf of Mexico. Finally, I had to look at the oil spill from the auditor’s standpoint and decide if the potential estimated losses were high enough based on the research on the affected people and areas.

I learned from this case the complexity of some of the estimates that auditors must make in cases like this. I had no idea exactly what went into deciding how much to allocate for different damages when an event like this happened. I found it very interesting to study this because I can remember as a kid watching this oil spill occur on live TV, and now being able to go through all the cost of it gives me a better understanding of how catastrophic it was.

A. Contingent liability is a potential liability that may occur, depending on the outcome of an uncertain future event. A company records a contingent liability on its books when it is expected and easy to estimate a loss. Some examples of contingent liabilities are for pending lawsuits, product warranties, and environmental contamination events. Companies never report contingent assets even when the chance of a future gain is probable.
B. From BP’s perspective, a product warranty is something that will help them in the long run if any of their telescopic joints break down. The warranty is a promise that if the telescopic joint BP bought malfunctions within the first two years it will be replaced by a new one free of charge by GE. From the perspective of GE, the warranty is an expense and a liability at the initial sale date. If BP has a defective product and GE has to pay, then the liability account is debited and cash, parts, etc. are credited. The warranty for GE represents a promise to give BP replacement products at a later date if the products GE gave BP originally malfunction.

C. The judgement that management needs to make for contingent liabilities is how probably the loss is to occur, and the estimated cost of the loss if the loss occurs. Specifically, for accrued warranty costs, management must decide on an estimate for the total amount of warranties that will be exercised in a year. They can make this estimate using a percentage of sales or as an arbitrary number based on data from years past. The claim for the Deepwater Horizon oil spill differs from a warranty claim for a piece of machinery because of the ability to define the cost of each event. It is difficult to put a price on the damages cause by the oil spill because the effect of oil in the ocean has huge repercussions and no definite price, on the other hand a piece of equipment has a specific price associated with it.

D. BP must estimate for the different types of effect that the oil spill had on people. BP must estimate the cleanup cost associated with the spillage of oil all through the ocean as a result of the spill. These costs would include the cost of chemicals that can be used to break down the oil. It would also include the costs of booms
and skimmers that help contain and collect the oil form the ocean. Another estimated cost for BP would be the cost of the government response to the oil spill. These costs would include paying the Coast Guard and other government agencies for their efforts in the clean-up and containment process. This expense would also include the cost to pay fines, penalties, and legal expenses from the government for the oil spill. The government can sue companies for violating the Clean Water Act. BP also needs to account for the property and natural resource damages. BP must estimate the total cost of the harm to the environment that the oil caused on the coast. Another factor BP must consider is which other parties are responsible for the spill. For example, BP must estimate how much liability the rig owner Transocean has. Finally, BP must decide the economic costs of the oil spill on the different coast industries. These costs would include lawsuits from different parties, industries, and cities who lost money because of the effects of the oil spill. As an auditor of BP, drawing the line around what is a potential loss and what isn’t is challenging. The PCAOB states that a potential loss is something that should be estimated if it is probable that the loss will occur, and the amount of the loss can be reasonably estimated. The difficulty in accounting for the potential loss from an oil spill is that good estimates are hard to come up with, and the auditor must decide if each estimate is valid or not. A process to determine this validity would be to look at other cases of oil spills and see how those auditors accounted for the different potential losses. Lawsuits against an oil spill can come from many industries from fishing, tourism, agricultural, and many more. This is because the oil effects not only the water, but the people, animals,
and plants that use the water. Also, the lawsuit must reasonably prove negligence on the part of BP, which could come from not inspecting pipes or not keeping up with industry safety standards. The potential loss accrual by BP for businesses effected by the oil spill was 20 billion dollars. I think this amount is reasonable and fair given the impact area that could be effected by the oil spill. The whole Gulf of Mexico basically could be contaminated and what that comes all the coast industries for the whole Gulf.
Case 9

Wendy’s Equity Method

Jones Albritton

Accy 420
Introduction:

In this case, we looked at the effect of the equity method on the balance sheet, income statement and statement of cash flows. A joint venture is when two parties combine to accomplish a specific task. Wendy’s entered into a joint venture with Tim Horton in which Wendy’s bought 50 percent of Tim Horton’s stock to start TimWen. I was asked to then analyze the effect of this 50 percent stake on the different accounts of Wendy’s. The equity method was used by Wendy’s when accounting for this joint venture because they acquired an amount large enough to exert significant influence on Tim Horton. Significant influence means that Wendy’s can have representation on the board of directors. Wendy’s, as a result of having significance influence, could also be involved in policy development as well as the hiring of executives for Tim Horton.

I learned how much the equity method effects the different accounting statement. I had no idea the effect of Tim Horton’s net income and dividends on the Statement of Cash Flows for Wendy’s. I thought it was very interesting how all of the transactions for the equity method were presented on the income statement. I found it odd that the share of net income of Tim Horton was buried in the other operating expenses net account. I feel like the net income of a subsidiary should be listed as its own line on the income statement. Listing the net income as its own line would be more transparent from a corporate reporting standing. I thought this case was a great application of a concept that we recently covered in intermediate.
A. Joint ventures are a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity. In a joint venture (JV), each of the participants is responsible for profits, losses and costs associated with it. However, the venture is its own entity, separate from the participants' other business interests. It is used when a company thinks combined with another company they can achieve even more profits than if they were separate.

B. The equity method is the standard technique used when one company has a significant investment in another company usually 20 to 50 percent. When a company holds approximately 20 percent or more of another company's stock, it is considered to have significant control, which signifies the power one company can exert over another. This power includes representation on the board of directors, partaking in policy development, and the interchanging of managerial personnel. The initial investment is accounted for by debiting equity investment and credit the cash for the transaction amount of $89,370 million. The other entries made are the entry to account for the net income of Tim Horton. This entry would be a debit to equity investment and a credit to investment income. Finally, the entry to record dividends paid out by Tim Horton would be a debit to cash and a credit to equity investment. The importance of these entries is to show that since Wendy’s has a large stake in Tim Horton their investment value fluctuates with how well Tim Horton is doing each year. The accounting to increase equity investment for Wendy’s portion of Tim Horton’s net income and decrease it for their dividends from Tim Horton makes sense because Wendy’s power it can
exert of Tim Horton means that their investment is tied to the results of Tim Horton.

C. First of all, the excess is used to write up the net assets to the fair value. This is done using the acquisition accounting premium account. The amount left over once the write up of net assets is done will be placed in the goodwill account. The AAP amount accounts for depreciation and amortization by using the equity investment account. The goodwill is checked for impairment at the end of every year, and if impaired written down to the new fair value.

D. The amount of their equity investment in Tim Horton in 2011 was $91.742 million and the amount in 2012 was $89.370 million. Both of these numbers are included in the investments section of the Balance sheet. They are part of the total for investments in 2011 and 2012.

E. The initial investment in TimWen was $35.283 million, which is 50 percent multiplied by the net assets of $70.565 million. The amount recorded on December 30, 2012 for the investment of TimWen is $89.370 million. The difference in these two numbers is the AAP, acquisition accounting premium, which is the write up to make the assets to fair value. This amount includes goodwill.

F. Note 8: Investment in TimWen

i. In both 2011 and 2012, the equity method investment affected earnings in the other operating expenses section of the statement of operations. The effect of this in 2011 was an increase in earnings of $10.571 million and in 2012 an increase of $10.551 million.
ii. The journal entry is a debit to equity income and a credit to equity investment for $13.68 million.

iii. The amount of the amortization for 2012 was $3.129 million. The journal entry would be a debit to equity income and a credit to equity investment.

iv. The amount of the dividend in 2012 was $15.274 million, and the amount of the dividend in 2011 was $14.942 million. The journal entry would be a debit to cash and a credit to investment income each for $15.274 million.

G. Statement of Cash Flows

i. The reason for the subtraction of the net income from the equity investment is because although that number is used to calculate Wendy’s net income Wendy’s is not exchanging any cash. Wendy’s is only adjusting the equity investment account to fair value so therefore the $8.724 million must be subtracted as it is not a part of the cash flows of Wendy’s. To get the $8.724 million you take the $10.551 million from the net income of TimWen and subtract the $1.827 net loss from the Japan JV equity investment.

ii. The $15.274 million increase to net income is a result of the dividends paid to Wendy’s from their equity investments. This number is added back to net income because Wendy’s received this cash for their stake in their investment. The number was originally subtracted out of the equity investment account, but since you are paid this dividend it is cash that was received for their investments and therefore added to net income to find the cash flows.
Case 10

Johnson and Johnson Retirement Obligation

Jones Albritton

Accy 420
Introduction:

This case was about the retirement obligations of Johnson and Johnson. The case made me look into the financials of Johnson and Johnson, and find the numbers that related to their pension fund and pension obligations. The income statements and balance sheet both have information in them that related to the retirement obligation of Johnson and Johnson. These numbers could also be found in the section titled Pension and Other Benefit Plans, which included schedules of data about the plan assets as well as the benefit obligation. Once I located the numbers in the financials, I had to analyze them to see how the plan was funded. Also, I analyzed the data to understand how much the plan assets grew and how much the retirement plan obligation grew. These metrics that I looked for are important to understanding if the employee benefits plan is overfunded or underfunded. The importance understanding if the retirement plan is overfunded or underfunded is that if the fund is underfunded there is a chance that some employees will not get their retirement benefits once they retire.

In this case, I learned where different items in a pension worksheet show up on the balance sheet and income statement. I also learned exactly how the different components of a pension worksheet can add or subtract from the retirement plan benefits and the plan assets. I learned what makes up pension expense, and the importance of good estimates for the pension plan. Many of the numbers on the pension plan are estimated based on actuarial assumptions, and those assumptions need to be correct or the fund will be underestimated or overestimated.
H.

i. In a defined benefit plan, the benefit that will be received is determined by the plan. The employer is in charge of making the contributions and those contributions vary, and therefore all the risk of the plan is on the employer. In a defined contribution plan, the benefits of the plan are determined by the plan value. Also, employer contributions are determined by the plan, and the risk of the plan is on the employees. Johnson and Johnson are using a defined contribution plan.

ii.

The employer funds the plan by putting cash into the plan assets that are being held by the pension plan management company. The Employee can also contribute to the plan, and when the employee retires the pension plan pays money out to them. The liability is the retirement plan obligation which is the estimate for the amount of money needed to cover the vested and non-vested employee’s retirement at their future salaries. Since the retirement plan obligation represents a future to pay the employees it is a liability.
iii. Some of the assumptions that are needed to compute the retirement plan obligations are expected returns and actuarial assumptions. The expected return assumption is the guess about the growth of the plant asset during the year. The growth can lead to a lower obligation. The actuarial assumptions are the estimates made about employee’s life choices, future salary, and life span.

I. The service cost is the expense that the employer pays every time the employee works another year. This cost increases the pension expense for the year, and increases the retirement plan obligation of the company. Interest cost are the costs based on at settlement rate that increases the retirement plan obligation and increases pension expense. Interest is the result of having the retirement plan obligation, which is a deferred compensation arrangement and therefore subject to a time value of money factor. Actuarial gains and losses are the result of changes in actuarial assumptions like the average life span of employees or the future salary numbers for employees. A gain will decrease the retirement plan obligation and a loss will increase it. Benefits paid to retirees is the amount paid out each year to people who have retired from the company. This event reduces the retirement plan obligation and also reduces plan assets.

J. The actual return on pension assets is the amount that year that the pension assets grew because of returns on investments made by the pension plan management company. The actual return increases plan assets. Company contributions to the plan are fluctuating amounts that the company contributes each year to help fund the pension plan. This will increase plan assets and decreases cash. Benefits paid
to retirees is the amount paid out each year to employees who have retired from the company. Paying retirees will decrease plan assets and decrease the retirement plan obligation.

**K.** The difference between the return on plan assets for pension expense and the pension plan assets is the use of expected or actual returns. The pension expense uses the expected return on plan assets because the pension expense is calculated before the end of the year when the actual return would be known. The pension plan asset account uses the actual return because it is the actual amount the assets have grown. The journal entry to record the return on plan assets if actual and expected were the same is: if they are different the entry would be:

```
Plan Assets     xx
Pension expense xx
(D/C) OCI-G/L xx
Pension Expense xx
```

**L.** Skip

**M.**

i. Johnson and Johnson reported a pension expense for 2007 of $646 million.

ii. Pension Expense $1.253 million
    Retirement Plan Obligation $1.253 million

**N.**

i. The December 31, 2007 balance of the retirement plan obligation is $12 billion. This represents the liability to pay retirement plans for the
employees. This number is reliable enough, but there are assumption and estimate made that could change the overall obligation in the future.

ii. The interest cost for 2007 is $656 million. The average interest rate used by Johnson and Johnson in 2007 is 5.619 percent. This rate is reasonable given that the discount rate for international is 5.5 percent and 6 percent for the US.

iii. Benefits paid out to retirees in 2007 are $481 million. Johnson and Johnson does not pay cash to pay out these benefits. The benefits are paid out of the plan assets. The entry to record benefits being paid out is a debit to the retirement plan obligation and a credit to plan assets for the $481 million dollars. This transaction decreases the amount in both those accounts.

O.

i. The value of the plan assets at December 31, 2007 is $10.469 million. This is the value of the actual amount the company has on hand to pay out retirement benefits.

ii. The expected return in 2006 was $701 million, and the actual return was $966 million. In 2006, the actual return was greater meaning there was a gain on the actual return on plan assets. The expected return was 2007 is $809 million, and the actual return was $743 million. In 2007, the actual return was less meaning there was a loss on the actual return on plan assets. The differences in 2006 is 37 percent change which is significant. In 2007, the percent change was 8 percent, which is not significant. The
actual return better reflects the economics of the company’s pension expense because it is the actual amount added to the plan assets.

iii. In 2007, Johnson and Johnson contributed $317 million to the plan and the employees contributed $62 million. In 2006, Johnson and Johnson contributed $259 million and the employees contributed $47 million.

iv. The type of investments that are in the plan assets in the US are equity and debt securities. The type included in plan assets for international plans are equity securities, debt securities, and real estate and other investments.

P. The company’s pension plan in 2007 was underfunded by $1.533 million. In 2006, the plan was underfunded by $2.122 million. This funded status shows up on the company’s balance sheet under the employee related obligations account.
Case 11

The Balance Sheet Model of Financial Reporting

Accy 420

Jones Albritton
Introduction and Summary:

The article by the Center for Excellence in Accounting and Securities Analysis discusses the balance sheet orientation for the purpose of financial reporting. The article first describes the differences in the two approaches. It states that the balance sheet approach puts the emphasis on the proper valuation of assets and liabilities, and everything else comes from these amounts. Also, the income statement amounts are governed by balance sheet considerations. For example, earnings would be the change in net assets. The article states the income statement approach puts an emphasis on revenue, expenses, and earnings with all other things being secondary to this. The income statement approach’s goal is to get the timing and magnitude of revenues and expenses correctly. The balance sheet method of financial reporting was adopted in the late 1970s after the formation of the FASB. The FASB decided that it was important to have one distinct method of financial reporting, and it chose the balance sheet approach over the income statement approach. The main reason for making this choice was the fact that, in the mind of the FASB, the idea of earnings was based on a change in value when the “value” was not even defined yet; therefore, the FASB chose the balance sheet approach and argued that it was conceptually superior. This article argues that this fundamental assumption that the balance sheet method of accounting is superior is wrong, and that the income statement approach is far better in business and the accounting profession.

The first argument made by the article is that the balance sheet approach is at odds with how businesses operate, create value, and are managed. The reason it argues this is that businesses do not look at their assets to decide if they have a profitable company they look at income and earnings. The paper states that firms are asset furnaces
that burn up assets to create revenue and earnings. Using this argument, assets are temporary and subservient to make revenue and earnings. The balance sheet approach makes firms seem like they are asset farms where the goal was to grow assets to make money. This is a vast disconnect from how the business world views the assets that they own. Also, in this section the article talks about how accounting is defined as the process of tracking wealth, and wealth deals with income and earnings not what your asset totals are. It also states that managers and investors make decisions based on the income statement approach. Managers make the revenue budget first meaning that the most important numbers for them are the revenue and expense numbers. Investor’s most important metric is the earnings of a company, and that is an income statement amount. Also, analysts do many projections of income statement numbers, but none of balance sheet numbers. The balance sheet model bases asset on the value of exchange, fair value, while the business world bases asset on the value in use. An example of this would be the fact that PPE is adjusted to fair value every year, however 98 percent of these assets will never be sold they are just used and depreciated internally.

The next argument the article makes is that the conceptual supremacy of the balance sheet is questionable, and that it can be argued that income is a clearer and stronger foundation. The FASB considers “asset” the most important fundamental concept of accounting, and that all others can be derived from it. The FASB also defines an asset as something that has “probable future economic benefit” which the article argues means expected earnings. The argument is that Assets and revenue are linked, but that today with more intangible assets showing up that the revenue is more easily identifiable. The article states that intangibles are most of a firm’s assets these days, and
the way to account for intangibles is to use projections and then discount income. Therefore, if most of the assets are intangible and intangibles are estimates accounted for by using some sort of income number, then revenue is the clearer number to find. Also, Income in concept is easy to see because it is just where the company is making money.

The final two arguments the article makes are that the balance sheet is a contributor in the decline of the forward-looking usefulness of earnings, and that the balance sheet approach in practice is hard to apply. The result of using the balance sheet approach is the use of many valuation accounts to adjust for the fair value of the assets that result in write-offs and other one-time charges to income. This makes the earnings each year unpredictable, and harder to properly estimate future earnings. The article states that in the last 40 years earnings volatility has doubled and earnings persistence has declined too. As a result of this volatility the relationship between stock price and earnings has declined. This has increased the gap between unsophisticated and sophisticated investors, which is what regulators like the SEC are trying to defend against. The balance sheet approach is also hard to apply in practice because of the use of large estimates in the valuation of assets. An example of the use of estimates gone wrong would be the Enron scandal. Also, market to market and fair value accounting leads to a feedback loop between financial markets and the economy which can lead to market bubbles. An example of how this works is that fair value numbers are found using market prices which can derive from fundamental economic values.

The article offers two suggestions to make a better framework at the end of the article. The first suggestion is to have a sharp theoretical and practical distinction between operating and financing activities and assets. Currently, operating activities
cover most of operating and investing activities. The article argues that the income statement must clearly distinguish between the earnings from regular operations and earnings due to the fluctuation in financial assets. This could mean having more than one bottom line earnings number, but on the other side it would be a clearer picture of a company’s true earnings for a year. The article states that the balance sheet needs to separate operating and financing assets. The point of doing this would be to show the operating assets that just signify expiring cost that will be used internally, and the financial assets that will be sold market to market at fair value. This would allow the balance sheet to use fair value estimates for the financial assets and cost estimates for the operating assets. The second suggestion the article makes is a renewed emphasis on the revenue recognition and matching principles in accounting for operating activities. The result of putting more emphasis on this would be that the accounting would match the business process of matching cost and benefits. Matching costs and benefits is at the very core of how businesses work.

**Question 1: How did reading this article change your current way of thinking?**

First off, before reading this case I really had not put too much thought into the underlying difference between the balance sheet or income statement method of financial reporting. I think one of the major things that this article made me realize is exactly how most companies use their assets. I had not thought about how assets to most companies are just something that is used up to create the revenues that make a company continue to operate. In my opinion, that is one of the main reasons I think the article is correct when it says the income statement method is a better depiction of how businesses operate. I also agree with the article with the fact that accounting should always depict what the
business reality I, and the income statement approach does the best job at depicting this reality. I did not think about the fact that the foundational block of the balance sheet method is assets, and that assets these days are mostly intangibles with valuation accounts. The result of this is that it is harder for accountants to get the correct asset number because of so many estimates. All of this affects the balance sheet method because if your base and foundational block is an estimate and hard to calculate then how do you know if any of your numbers are truly correct. Another part of this article that got me thinking was that accountant’s job is to provide useful information to the shareholders of the company, and using the balance sheet approach does not give the shareholders the right base for the information they deserve to have. For the shareholders to see through the eyes of the managers to understand what it going on with the company the income statement approach is needed. This is due to the fact that in the current system earnings has become increasingly hard to predict, and this increased volatility is due to the valuation of assets. Specifically, the increased use of fair value for assets and as a result of this the increase in valuation accounts and one-time charges against income resulting and more earnings volatility. Another thing that I learned was the importance of earnings for many investors in the company. I always knew that earnings and revenue were important when looking at the performance of a company I just did not realize that it was the biggest indicator to an analyst looking to see if the company is worth investing in. With this new knowledge, I understand the importance of needing to do financial accounting using the income statement method so that analyst can properly estimate future earnings without any intangible asset skew due to valuations and fair value adjustments. Finally, this article got me thinking about why the use of fair value is
important for some assets. The article talks about how 98 percent of assets do not need to be valued at fair value because they are never sold, and only depreciated internally to help the company run. The idea that there should be operating assets that are listed on the books only at cost is something that I had never thought of, but that makes a lot of sense. There is no need to list assets at fair value if the point of fair value is to give a price that you could sell an asset for if the asset will never even be put up for sale.

**Question 2: How will I use this information in my future career?**

I think this information will be useful in my career as an auditor in public accounting. First of all, just having a better understanding of the reasoning behind the accounting profession using the balance sheet method is useful because it gives me some insight into why not just what the standard method is. I think one specific example of how I could use this would be the inventory count of a company that would be performed on an audit. Understanding the core importance of all of the asset numbers means that I would put a big emphasis on making sure the count is as correct as it could possibly be by making it a bigger priority to me. Another example for public accounting would be to help company’s owners to better understand the reasoning behind some of the things that an auditor does. If the audit committee understands why the auditor is doing certain things and asking for certain things then they would know how to better accommodate the audit so that it can run smoothly. For later on in my career if I am not in public accounting this can still be something that I can lean on for my understanding of companies. I think being able to understand how a company reports earnings can help for when I am looking to invest in companies down the road if I am out of public accounting. Having the knowledge to know that a company’s earnings can be skewed by different
asset estimates and valuations, and know where those show up on the income statement could give me an edge in what the company’s actual earnings are without the random asset skew. My beliefs after this article are that the balance sheet model is not practical anymore, and that there should be a switch to the income statement method of financial reporting. This belief will lead me to question the practicality of the revenues and earnings that re stated on the income statement because I know that they draw from the assets which more likely than not will be a bunch of estimates of the intangibles that a company has. Finally, I think understanding fundamentally that in most businesses assets are just used to produce profits could help while I am in public accounting. Understanding how a company works is a fundamental component in completing an audit because if you do not know how a company works then how are you supposed to successfully and properly audit their operations.
Case 12

Google’s non-GAAP Measures

Accy 420

Jones Albritton
Introduction:

This case was about the use of GAAP and non-GAAP financial information. In this case, I was asked to read about what the non-GAAP performance measures are. Non-GAAP performance measures are items that are not included in the GAAP calculation because they can be considered non-recurring, infrequent, unusual, or smoothing and therefore not indicative of a company’s primary performance. Then, I had to explain as it related to Google why the GAAP and non-GAAP net income was different. These differences stemmed from stock based compensation and other expenses that were non-recurring or infrequent. I was then asked to look at an article along with the earnings and stock price for Google about the performance of Google in 2013. Google in 2013 was steadily growing, and the stock price as well as the earnings were higher than 2012.

I learned in this case that non-GAAP measures are useful just like GAAP measures. I realized that the non-GAAP numbers sometimes gives the investors a better view of the company through management’s eyes. I also learned that the earnings and revenue of a company are not the only measures that affect the overall performance of a company’s stock. The stock can also be affected by different sources of revenue in company as well as the performance of other companies in similar market segments. Finally, I learned that GAAP and non-GAAP metrics are both hard to compare with other companies. I think this case was very informative on how the data, GAAP or non-GAAP, can be helpful for investors to understand the inner workings of the company.

H.

i. Not included in case study.
The differences in GAAP and non-GAAP net income is because of the numbers representing a company’s historical or future financial performance, financial position, or cash flows that excludes amounts otherwise included in or excluded from in the most directly comparable U.S GAAP measures. In the case of Google, this means excluding expenses related to SBC and, as applicable, other special items less the related tax effects, as well as net income (loss) from discontinued operations. I think management has the flexibility to present non-GAAP performance measures as they see fit. I agree with most Google’s adjustments in what they can include and exclude from non-GAAP net income. In my opinion, all of their adjustments except stock compensation expense are acceptable with the appropriate explanation. Stock compensation expense must be included because it is recurring and an operating expense.

I.

i. During 2013 Google’s fiscal earnings increased by 490 million dollars in GAAP earnings and fiscal earnings increased by 528 million dollars in non-GAAP earnings. Google’s stock price during 2013 increased by 413 million dollars. Therefore, both the fiscal earnings, and the stock price increased during 2013.

ii. The stock price of a company is equal to the discounted of all future earnings. In 2013, Google’s stock outperformed the NASDAQ index
except in October of 2013 when for a short time the NASDAQ had a better return.

iii. Based on the data for Google’s stock at January 30, 2014 the market perceived the earnings release as bad news initially. On January 30, 2014, the stock for Google was at a peak, and the next day it dropped as a result of the press release after closing hours on January 30. However, the stock rebounded and rose above the January 30, 2014 closing amount by February 14, 2014.

J.

i. Google’s fourth quarter revenue slightly beat the estimate. The estimate made by analysts was 16.8 billion dollars, and the actual revenue was 16.9 billion dollars. Google’s fourth quarter earnings were lower than the estimate by 19 cents per share. The estimate for earnings made by earnings was 12.20 dollars per share, while the actual earnings were 12.01 dollars per share. These relations are consistent with positive stock market reaction because beating revenue estimates as a result of your main business line of ad revenue increasing by 80 percent signifies a positive sign for your business to come.

ii. The other factors that can contribute to the positive earnings would be the increase in revenue generated by ad revenue. Also, the fact that Facebook, another technology online company, reported increased profits of 63 percent. Finally, app sales for Google doubled from the previous year to 1.7 billion dollars. The things that could be a red flag for investors of Google would be the 2 billion dollars of operating losses from its smartphone division since
2012. Also, the earnings of Google not meeting the earnings estimate could signify a red flag for investors.
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