Spring 5-9-2020

Comprehensive Case Studies of Financial Reporting Principles and Professional Development Topics

Caroline Bailey

Comprehensive Case Studies of Financial Reporting Principles and Professional Development Topics

by
Caroline Bailey

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

Oxford
May 2020

Approved by

Advisor: Dr. Victoria Dickinson

Reader: Dean Mark Wilder

ABSTRACT

CAROLINE BAILEY: Comprehensive Case Studies of Financial Reporting Principles and Professional Development Topics
(Under the direction of Dr. Victoria Dickinson)

The purpose of this paper was to investigate financial reporting and professional development topics through the analysis of twelve original cases. The following case studies were completed over the course of a nine months in an independent study class in fulfillment of the requirements of the Sally McDonnell Barksdale Honors College, under the direction of Dr. Victoria Dickinson. Topics looked at included, but were not limited to, data analytic software, the creation of basic financial statements, treatment of various types of debt securities sales, and capitalization v. expensing of costs. Each case study introduced a new topic centered around a real company that dealt with the issue at hand in the course of regular business. Then, students were guided in their analysis by a series of questions presented by Dr. Dickinson. The case studies and analysis led to further understanding of U.S. Generally Accepted Accounting Principles. This paper also provided experience with real financial statements and company performance and allowed students to progress beyond undergraduate education.

TABLE OF CONTENTS

CASE 1: DATA ANALYTIC SOFTWARE EXPLORATION

Tableau

4 September 2018

I. Introduction

Data analytics is the process of analyzing raw data to find trends and patterns to answer questions and base decisions. As such, this process is an essential aspect of making sound business decisions. In the world today, many programs exist to make the task of analyzing raw data, specifically large amounts of raw data, easier for companies. This case analysis provided the opportunity to explore Tableau, a data analytics programs, through manufactured business scenarios. After, exploration of the software, a memo was written to a fictional firm's partner about the usefulness of investing in and adopting the software for use in the company. For a future career in the business world, this case provides an advantage over peers, because I am now familiar with the applications of data analytic software. I am also informed about the Tableau program, which is being implemented in major public accounting firms across the world.

II. Purpose and Usefulness of Tableau

Tableau is a data analytic software that allows users to transform millions of bytes of data into useful visual aids, even the untrained eye can understand. Businesses are able to use this program to turn large reports into trends and patterns, enabling decision makers to determine proper courses of action from marketing to tax planning, much faster than if they were only looking at tabular data.

Tableau is used to make internal and external decisions in every major industry. Businesses are able to use Tableau to visualize internal processes to see where inefficiencies are and then perform corrective actions. The ability to analyze huge amounts of data allows the user to make external decisions as well, such as comparing customer information based on state, gender, age, shopping habits, etc. Companies can then decide what region to expand to, how to meet demand, how to market to their main audience, if they need to discontinue certain practices, and more.

III. Scenarios

A. Auditing

i. When auditing a client for sales tax, Tableau can produce graphs based on the year's sales and show projections for the amount of sales tax that should have been paid. By setting up automatic alerts, if the amount of sales tax paid for the year is not within a certain range, an auditor can easily find red flags without having to sift through voluminous sheets of numbers.

ii. A client is being audited for multiple years and uses the software QuickBooks for their accounting purposes. Tableau easily transfers data from multiple programs, including QuickBooks, and would cut down on time used to transfer data into a manageable form.

B. Tax Planning

i. A multinational corporation is looking to expand their automotive sales to an additional country. They have narrowed the options to two different countries, India and Morocco, based on projected sales. Since projected sales and other costs are the same, the client would like to see what effect expanding would have on the amount of taxes paid. Tableau would be used to create multiple visual aids, called a dashboard, to compare each country's tariffs for an assembly plant, distribution center, or manufacturing plant. The program allows the client to evaluate scenarios side by side and choose the country and site where they would pay the least amount of taxes.

ii. A client that owns multiple farms in the state of Mississippi is buying a piece of property in Alabama but does not know what type of farming to use the land for. He would like to see a graph of the tax breaks for cattle, bees, and produce. Tableau would create a visual aid the client could read and understand without any data analytic background, allowing for the effective spread of knowledge.

IV. Memo to Partner

To whom it may concern:

Currently, the company wastes valuable time and resources on reading large quantities of data, attempting to find meaning. Once a pattern is found, the data is usually irrelevant for decision making. Tableau is a data analytic software that can solve this problem. Tableau transforms millions of bytes of data into an easy to read visual model in just minutes. Investing in this software will save the company time and money, by allowing human resources to work on more pressing matters.

Not only will this software program give time back to employees but ease the transfer of knowledge to clients. With bright, attention-grabbing graphs, Tableau makes spotting trends and patterns simple, even for those without in prior training. Overall, Tableau can increase productivity of employees, efficiency of processes, and the effectiveness of our data. I highly recommend investing time and money into the acquisition and training of this program.

Sincerely,

Caroline Bailey

CASE 2: CREATION OF FINANCIAL STATEMENTS

Rocky Mountain Chocolate Factory

10 September 2018

I. Introduction

Financial statements are written records that provide information to the reader about a company's business activities and financial performance for the period. They include a balance sheet, income statement, statement of cash flow, and statement of shareholder's equity, prepared in that order. Publicly traded companies must prepare financial statements for external users, such as lenders and shareholders, four times a year. They must also have their financial statements and internal controls audited at year-end. As such, understanding the purpose of financial statements and the information included is vital to an accountant, whether in the public or private sector. This case provided the opportunity to create financial statements with various tools in Excel based on Rocky Mountain Chocolate Factory's financial records. In the sections below are the general journal, income statement, balance sheet, and transactions categorized by type of cash flow. All creations were based on the financial records and transactions of Rocky Mountain Chocolate Factory, as provided by Dr. Dickinson.

II. General Journal: Part One

Account Name	Beginning Balance (February 28, 2009)	1. Purchase Inventory	2. Incur Factory Wages	3. Sell Inventory for Cash and on Account	4. Pay for Inventory	5. Collect Receivables	6. Incur SG&A (cash and payable)	7. Pay Wages	8. Receive Franchise Fee	9. Purchase PPE	10. Dividends Declared and Paid	11. All Other Transactions
Cash and Cash Equivalents	$ 1,253,947.00			$ 17,000,000.00	$ (8,200,000.00)	$ 4,100,000.00	$ (2,000,000.00)	$ (6,423,789.00)	$ 125,000.00	$ (498,832.00)	$ (2,403,458.00)	$ 790,224.00
Accounts Receivable	$ 4,229,733.00			$ 5,000,000.00		$ (4,100,000.00)						$ (702,207.00)
Notes Receivable, Current	$ -											$ 91,059.00
Inventories	$ 4,064,611.00	$ 7,500,000.00	$ 6,000,000.00	$ (14,000,000.00)								$ (66,328.00)
Deferred Income Taxes	$ 369,197.00											$ 92,052.00
Other, Current	$ 224,378.00											$ (4,215.00)
Property and Equipment, Net	$ 5,253,598.00									$ 498,832.00		$ 132,859.00
Notes Receivable, Noncurrent	$ 124,452.00											$ 139,198.00
Goodwill, Net	$ 1,046,944.00											
Intangible Assets, Net	$ 183,135.00											$ (73,110.00)
Other, Noncurrent	$ 91,057.00											$ (3,007.00)
Accounts Payable	$ 1,074,643.00	$ 7,500,000.00			$ (8,200,000.00)							$ 503,189.00
Accrued Salaries and Wages	$ 423,789.00		$ 6,000,000.00					$ (6,423,789.00)				
Other Accrued Expenses	$ 531,941.00						$ 3,300,000.00					$ (2,885,413.00)
Dividend Payable	$ 598,986.00										$ 3,709.00	$ (1.00)
Deferred Income	$ 142,000.00								$ 125,000.00			$ (46,062.00)
Deferred Income Taxes	$ 827,700.00											$ 66,729.00
Common Stock	$ 179,696.00											$ 1,112.00
Additional Paid-In Capital	$ 7,311,280.00											$ 315,322.00
Retained Earnings	$ 5,751,017.00										$ (2,407,167.00)	
Sales	$ -			$ 22,000,000.00								$ 944,017.00
Franchise and Royalty Fees	$ -											$ 5,492,531.00
Cost of Sales	$ -			$ 14,000,000.00								$ 693,786.00
Franchise Costs	$ -											$ 1,499,477.00
Sales & Marketing	$ -						$ 1,505,431.00					
General and Administrative	$ -						$ 2,044,569.00					$ (261,622.00)
Retail Operating	$ -						$ 1,750,000.00					
Depreciation and Amortization	$ -											
Interest Income	$ -											$ (27,210.00)
Income Tax Expense	$ -											$ 2,090,468.00

III. General Journal: Part Two

Account Name	Unadjusted Trial Balance	12. Adjust for Inventory Count	13. Record Depreciation	14. Wage Accrual	15. Consultant's Report	Pre-closing Trial Balance	Closing Entry	Post-closing (ending) Balance	Actual February 28, 2010 F/S Figures
Cash and Cash Equivalents	$ 3,743,092.00					$ 3,743,092.00		$ 3,743,092.00	$ 3,743,092.00
Accounts Receivable	$ 4,427,526.00					$ 4,427,526.00		$ 4,427,526.00	$ 4,427,526.00
Notes Receivable, Current	$ 91,059.00					$ 91,059.00		$ 91,059.00	$ 91,059.00
Inventories	$ 3,498,283.00	$(216,836.00)				$ 3,281,447.00		$ 3,281,447.00	$ 3,281,447.00
Deferred Income Taxes	$ 461,249.00					$ 461,249.00		$ 461,249.00	$ 461,249.00
Other, Current	$ 220,163.00					$ 220,163.00		$ 220,163.00	$ 220,163.00
Property and Equipment, Net	$ 5,885,289.00		$ (698,580.00)			$ 5,186,709.00		$ 5,186,709.00	$ 5,186,709.00
Notes Receivable, Noncurrent	$ 263,650.00					$ 263,650.00		$ 263,650.00	$ 263,650.00
Goodwill, Net	$ 1,046,944.00					$ 1,046,944.00		$ 1,046,944.00	$ 1,046,944.00
Intangible Assets, Net	$ 110,025.00					$ 110,025.00		$ 110,025.00	$ 110,025.00
Other, Noncurrent	$ 88,050.00					$ 88,050.00		$ 88,050.00	$ 88,050.00
Accounts Payable	$ 877,832.00					$ 877,832.00		$ 877,832.00	$ 877,832.00
Accrued Salaries and Wages	$ -			$ 646,156.00		$ 646,156.00		$ 646,156.00	$ 646,156.00
Other Accrued Expenses	$ 946,528.00					$ 946,528.00		$ 946,528.00	$ 946,528.00
Dividend Payable	$ 602,694.00					$ 602,694.00		$ 602,694.00	$ 602,694.00
Deferred Income	$ 220,938.00					$ 220,938.00		$ 220,938.00	$ 220,938.00
Deferred Income Taxes	$ 894,429.00					$ 894,429.00		$ 894,429.00	$ 894,429.00
Common Stock	$ 180,808.00					$ 180,808.00		$ 180,808.00	$ 180,808.00
Additional Paid-In Capital	$ 7,626,602.00					$ 7,626,602.00		$ 7,626,602.00	$ 7,626,602.00
Retained Earnings	$ 3,343,850.00					$ 3,343,850.00	$ 3,580,077.00	$ 6,923,927.00	$ 6,923,927.00
Sales	$ 22,944,017.00					$ 22,944,017.00	$(22,944,017.00)	$ -	$ 22,944,017.00
Franchise and Royalty Fees	$ 5,492,531.00					$ 5,492,531.00	$ (5,492,531.00)	$ -	$ 5,492,531.00
Cost of Sales	$ 14,693,786.00	$ 216,836.00				$ 14,910,622.00	$(14,910,622.00)	$ -	$ 14,910,622.00
Franchise Costs	$ 1,499,477.00					$ 1,499,477.00	$ (1,499,477.00)	$ -	$ 1,499,477.00
Sales & Marketing	$ 1,505,431.00					$ 1,505,431.00	$ (1,505,431.00)	$ -	$ 1,505,431.00
General and Administrative	$ 1,782,947.00			$ 639,200.00		$ 2,422,147.00	$ (2,422,147.00)	$ -	$ 2,422,147.00
Retail Operating	$ 1,750,000.00			$ 6,956.00		$ 1,756,956.00	$ (1,756,956.00)	$ -	$ 1,756,956.00
Depreciation and Amortization	$ -		$ 698,580.00			$ 698,580.00	$ (698,580.00)	$ -	$ 698,580.00
Interest Income	$ (27,210.00)					$ (27,210.00)	$ 27,210.00	$ -	$ (27,210.00)
Income Tax Expense	$ 2,090,468.00					$ 2,090,468.00	$ (2,090,468.00)	$ -	$ 2,090,468.00

IV. Income Statement

Revenues		
Sales	$	22,944,017.00
Franchise and Royalty Fees	$	5,492,531.00
Total Revenues	$	28,436,548.00
Costs and Expenses		
Cost of Sales	$	14,910,622.00
Franchise Costs	$	1,499,477.00
Operating Expenses		
Sales & Marketing	$	1,505,431.00
General and Administrative	$	2,422,147.00
Retail Operating	$	1,756,956.00
Depreciation and Amortization	$	698,580.00
Total Costs and Expenses	$	22,793,213.00
Operating Income	$	5,643,335.00
Other Income(Expense)		
Interest Income	$	27,210.00
Income Before Income Taxes	$	5,670,545.00
Income Tax Expense	$	2,090,468.00
Net Income	$	3,580,077.00

V. Balance Sheet

Assets		
Current Assets		
Cash and Cash Equivalents	$	3,743,092.00
Accounts Receivable	$	4,427,526.00
Notes Receivable, Current	$	91,059.00
Inventories	$	3,281,447.00
Deferred Income Taxes	$	461,249.00
Other, Current	$	220,163.00
Total Current Assets	$	12,224,536.00
Property and Equipment, Net	$	5,186,709.00
Other Assets		
Notes Receivable, Noncurrent	$	263,650.00
Goodwill, Net	$	1,046,944.00
Intangible Assets, Net	$	110,025.00
Other, Noncurrent	$	88,050.00
Total Other Assets	$	1,508,669.00
Total Assets	$	18,919,914.00

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

VI. Cash Flow Types

Transaction	Type
1. Purchase Inventory	Operating
2. Incur Factory Wages	Operating
3. Sell Inventory for Cash and on Account	Operating
4. Pay for Inventory	Operating
5. Collect Receivables	Operating
6. Incur SG&A	Operating
7. Pay Wages	Operating
8. Receive Franchise Fee	Operating
9. Purchase PP&E	Investing
10. Dividends Declared and Paid	Financing

CASE 3: EMPLOYMENT DECISIONS FACING UNDERGRADUATES

Reflection

18 September 2018

I. Introduction

Accounting undergraduates have many options available to them after graduation. One of the main routes pursued by graduates from the Patterson School of Accountancy is obtaining a masters and then being employed by a public accounting firm. However, this case presented three different scenarios that accountancy students could potentially face after graduation. The first scenario was based on a student interested in law school after graduation. The second scenario was based on two students in the accountancy major but uninterested in pursuing accounting as a career. The third scenario was based on a student unhappy with the city they completed their public accounting internship in. After hearing the basis of each scenario, every student would choose whether they agreed or disagreed with what happened. The class would then debate the opposing viewpoints. Students were free to change sides at any point during the debate, if they had been convinced by the opposing side's argument. After the debates, students were told to reflect on what was learned about themselves and the decisions the next few years have in store.

II. Scenario One

During scenario one, two students were discussing what they planned to do after graduating with their undergraduate degree in accountancy. One student intended to attend law school and practice tax law. He believed those who went to law school and practiced tax law made more money than those who got a Master of Accountancy and practiced tax law. However, he still wished to do an internship with a public accounting firm his junior year of undergraduate, even though he did not want to work for the firm after graduation. He believed it would pad his resume.

Students were to choose if they agreed he was right in still doing the internship and going to law school, or if this was wrong. I agreed still doing the internship was right, but the class was split evenly between the two viewpoints. I believe he will gain valuable experience working in public accounting that will be useful for his future career in tax law. However, the amount of money made should not be a deciding factor in his career goals. The professor pointed out while at first the student would make more money in tax law, the gap dissipates within two years.

III. Scenario Two

During scenario two, two students are majoring in accounting but want to enter the investment banking and consulting fields after graduation. They do not like the accounting classwork at all. A third student poses the question about having majors related to the fields they would like to work in. For this scenario, I agreed with the third student. However, most of the class was on the side of the first two students.

I was slightly confused by my peers' conclusions, because I did not see how this was different then a student majoring in accounting and going to law school for tax law. Many of my peers were vehemently against that notion, but for this one, they thought there was a difference. I believe that the students would gain better knowledge from having a degree in their field. While accounting is "the language of business" as one peer said, banking and consulting have specific skills needed that would be taught in that major. Another peer stated that public accounting firms could place you in a position dealing with banking and consulting, but that is only true for a small number of people.

One important statement was brought up multiple times during our debates, “if you do not want to be there, they do not want you there.” This resonated with me, because I have always considered doing something different from public accounting.

IV. Scenario Three

Scenario three was an email from one of Dr. Dickinson’s previous students, currently in graduate school. He completed his internship in Washington, D.C. He was trying to have his job offer transferred to Dallas; If he could not, he was planning to quit and work for a firm different from the one he did his internship with. The question was, “Could we ever see ourselves in this position?” Few students said no. The majority of us could see ourselves disliking the city we do our internship in, not fitting into the work environment, etc. and wanting to switch cities.

The main point many students had was we are only in our early twenties and do not know what our life will look like in a year or two. The counter argument to this was that while we are young, we do not need to go into the recruitment process thinking this is an opportunity to see a different city for a few months and then transfer home.

V. Conclusion

One important statement was brought up multiple times during our debates, “If you do not want to be there, they do not want you there.” This resonated with me, because I have always considered doing something different from public accounting after graduation but plan to still participate in the internship. However, firms invest thousands of dollars in securing students for their positions and do not recoup their investment until the student comes back full-time and stays at the firm for two to three years.

This made me contemplate whether this was the field for me. I do not want to burn a bridge with a firm if I decide to intern and not come back. Overall, I have decided I would like to stay in the public accounting world for as long as I am being challenged past the first three years. I feel as this is only fair to those who invest so much time, resources, and money into my personal and professional life.

CASE 4: ACCOUNTING FOR DEBT SECURITIES SALES

Generic Bank

2 October 2018

I. Introduction

Available for sale debt securities are debt and equity securities to be sold in the near term but are not classified as trading securities. Unlike trading securities, available for sale securities are recorded at fair value on financial sheets. If the fair value drops below cost to a point where the company cannot recover the loss, the securities are pronounced impaired. In this case, Generic Bank is looking to sell seven AFS (available for sale) securities to free up resources to pay bonuses and invest at the beginning of 20X3. They have fulfilled all required debts for the year. Though the securities are in a net loss position, they have not reported an impairment for the year 20X2. Two determinants decide whether or not a company should report impairment of the AFS securities. The first is whether the decline in value is due to credit losses. Generic Bank asserted that credit losses were not the reason for the decline in value of their AFS debt securities. The second determinant is for the company to prove that they have the intent and ability to hold the securities until the cost basis is recovered. This was another assertion Generic Bank made in 20X2. This case discusses the various instances in which an impairment would and would not be reported and for which securities dependent upon certain criteria being met or not.

II. AFS Securities are Sold

Assuming Generic Bank does sell the aforementioned seven securities, they will have had an impairment to report in 20X2. As previously proven by Generic Bank, the loss was not due to credit loss. However, though they asserted the intent and ability to hold the seven securities, they did not truly intend to hold the securities. This is obvious by the fact that they did sell the securities prior to cost basis recovery. As such, an impairment should be recognized on five of the securities in 20X2. The remaining two securities had a gain, but the gain should be ignored.

III. Effect on Other Securities Held by Generic Bank

The next question of the case asked if the other securities held by Generic Bank, but not mentioned in this case as ones to be sold, should be impaired. Based on ASU 2016-13 part 326-30-35-1,4,5, there is no impairment on the rest of the securities held by Generic Bank. Assessment of securities is done on a CUSIP by CUSIP level. This means that securities are not to be aggregated unless they have the same CUSIP number. So, when Generic Bank asserted they had the intent and ability to hold the securities until cost basis was recovered, they proved this for each individual CUSIP. Since no other securities were sold, this assertion still holds true for those not sold.

IV. External Auditor's Opinion

The answer would change if I assumed the role of an external auditor or a bank regulator. Both of these entities are trained to be more conservative than a firm would be. So, the fact that Generic Bank sold the seven securities they had asserted the intent and ability to hold claim for would discredit this claim for every other security in their portfolio. The rest of the portfolio would be tainted even though no decision to the sell the other securities had been made or acted upon.

V. Effects of Net Gain Position

The assessment of requirements one and two would not change even if the securities sold had been in a net gain position. The impairments of the securities sold should still be recognized, and the gain ignored. However, if all seven securities sold were in a gain position, there would be no impairment, and a gain would be recognized on the securities.

VI. Securities in 20X2

Though Generic Bank did not impair all securities in 20X1, they will have an impairment loss in 20X2 on all securities, not just the seven sold. This is because they are not able to assert the ability to hold the securities until the cost basis is recovered. Generic Bank will more likely than not be required to sell the securities to cover borrowing obligations.

CASE 5: INTERNSHIP CITY PREFERENCES

Seattle, WA and Chicago, IL

5 November 2018

I. Introduction

This case asked students to explore their two top city preferences for their junior year internships and thus, places of residences after graduation. I looked at the two cities I am most interested in starting my career in: Seattle, Washington and Chicago, Illinois. Each city had different elements that drew me into them from the prevalent industry to geographical elements. I discussed the population, climate, industry, major expenses, and other deciding factors of both cities. After discussion of these factors, I compared the two cities to each other and my personal preferences for my future city. This case allowed me to better understand where I would like to live and start my career.

II. Seattle, Washington

A. Population and Crime

As the 15th largest metropolitan area in the country, Seattle and the surrounding area is home to 3.5 million people. The city itself has a population of 724,745. Representing 62 percent of all crime, 3,804 instances of theft occur per 100,000 people. However, murder in Seattle is below the US average, partially because property crime is more common than violent crime. Overall, Seattle is a relatively safe city, but some areas to avoid at night include the neighborhoods on the fringe of downtown, such as Belltown and Lower Queen Anne.

B. Climate and Physical Features

Seattle has a mild climate due to the Pacific Ocean nearby and the Cascade Mountain Range. Winters tend to be wet and warm, while summers are cool and dry almost never exceeding 80°F. While Seattle is known for its rainy weather, the city is below the average annual rainfall in other major cities. The rain does keep the city green year-round, earning the nickname, the "Emerald City." Seattle, Washington is located on the Pacific Coast of the United States, about 100 miles south of the Canada-United States border. The city is built on hills on the eastern shore of the Puget Sound, as well as the Seattle Fault, a tectonic feature. This causes the region to volcanically active. The area has great natural beauty due to the densely forested Olympic Peninsula and the Cascade Mountain Range surrounding the city.

C. Individual Tax Rates

In the state of Washington, no personal income tax rate exists. So, the tax paid on income would be the federal tax rate at 22 percent based on a $50,000 annual salary. $11,000 in taxes would be paid. Since no personal income tax exists, the sales tax in Washington and the property tax are some of the highest in the country.

D. Major Industries and Transportation Hubs

Seattle has a diverse economy with industries ranging from technology to agricultural. The major players, though, are aerospace, computer software development, and international trade. Boeing is a huge contributor to the aerospace industry, hosting their headquarters in Seattle. International trade is a large industry in Seattle, because of the two major transportation hubs, the Seattle-Tacoma International Airport and shipping port that is part of the Northwest Seaport Alliance. Seattle is also connected to markets across the Northwest and Midwest by railway.

E. Living and Social Opportunities

Based on my research, I would live in the Wallingford area for the first three years. Wallingford is near the Puget Sound and only a short drive from downtown. Average rent in the area is $1,500-$2,000. One possible apartment would be the Milan Apartments. The rent would be $1,450/month for a 603 sq. ft. one bedroom/one bath apartment. Many apartments, including the aforementioned have a washer and dryer unit, so I would be able to do laundry at home. Healthcare in the city of Seattle is known to be very good with more physicians per capita than the national average, but the cost is also higher.

Commuting to work, I would either use public transit or drive my personal vehicle. Since the apartment complex has garage parking, I would be able to keep a car in the city. I would begin my commute to work from 7:30AM-9:00AM in the morning and should only be in transit for 35 minutes based on the location of where I would like to live. Commute times leaving work would be around 6:00PM and last slightly longer than the travel in the morning.

I would grocery shop at local markets in the neighborhood, such as Markettime Foods and PCC Community Market. I would love to be involved in the local Arthritis Foundation in Seattle, the Newcomers Club of Greater Seattle, and the Puget Sound Beekeepers Association. A couple activities I would engage in during my time there would include kayaking the Puget Sound, visiting the Space Needle, attending hockey games for the Seattle Ravens, exploring the multitude of parks and arboretums, and hiking in the Olympic National Park. While I could drive to my hometown of Jackson, AL, this would be a long and arduous trip, so I would most likely fly. Flights from Seattle to my hometown would cost me $400 roundtrip.

F. Budget

Monthly Salary		$5,000
Income Taxes	$1,100	
Rent	$1,500	
Utilities	$200	
Phone/Internet	$150	
Car Insurance	$100	
Groceries	$500	
Misc. Spending	$450	
Total Costs		$4,000
Savings		$1,000

III. Chicago, Illinois

A. Population and Crime

Chicago has almost 2.7 million people living in the city, making it the third largest city in the United States and the largest city in Illinois. The next largest city in Illinois is Aurora at 200,000 people. Crime in Chicago is well above the national average, only being safer than 8 percent of U.S. cities. Gun violence is one of the most common crimes in Chicago. The south and west sides of the city are places that have some of the highest crime and gang rates, but the general advice is to never go anywhere alone.

B. Climate and Physical Features

Chicago has a wide range of weather with humid, warm summers and dry, cold winters. Winters in Chicago will produce some snowfall and many days below 30°F. The city of Chicago is extremely flat, due to once being the bottom of Lake Chicago. There are not many natural geographic features in Chicago other than Lake Michigan. However, due to man-made skyscrapers in Chicago, strong winds are known to plague the city, hence its nickname.

C. Individual Tax Rates

In the state of Illinois, the income tax rate recently increased from 3.75% to 4.95 percent. So, the taxes paid on income would be the federal tax rate at 22 percent based on a $50,000 annual salary plus 4.95 percent. $13,475 in taxes would be paid. However, Illinois has many other tax burdens, such as soft drink tax.

D. Major Industries and Transportation Hubs

Chicago is also a very diverse economy. The major industries are manufacturing, printing and publishing, insurance, and food processing, with no one industry dominating. One transportation hub in Chicago is the

O'Hare Airport. The city is also the rail hub for the nation with many railways meeting there.

E. Living and Social Opportunities

Based on my research, I would live in the Lincoln Park area. Average rent in the area is about $1,500. One possible apartment would be the Park Lincoln by Reside Apartments. The rent would be $1,515/month for a 448 sq. ft. one bedroom/one bath apartment. Many apartments, including the aforementioned have a washer and dryer unit, so I would be able to do laundry at home.

Commuting to work, I would either use public transit or drive my personal vehicle. There is some street parking by the apartment, but this could be a potential problem. I would begin my commute to work from 7:30AM-8:30AM in the morning and should only be in transit for 15 minutes based on the location of where I would like to live. Commute times leaving work would be around 6:00PM and last slightly longer than the travel in the morning.

I would grocery shop at local markets in the neighborhood, such as Big Apple Finer Foods. I would love to be involved in the local Arthritis Foundation in Chicago, Big Brothers Big Sisters of Metropolitan Chicago, and the Frank Lloyd Wright Trust. A couple activities I would engage in during my time there would include visiting the tourist attractions such as Cloud Gate, affectionately known as the Bean, explore the Art Institute of Chicago, attend Chicago Cubs games, attend concerts in Millennium Park, and attend comedy shows at Second City. This would be a long trip, so I would most likely fly. Flights from Chicago to my hometown in Alabama would cost me $300 roundtrip.

F. Budget

Monthly Salary		$5,000
Income Taxes	$1,348	
Rent	$1,500	
Utilities	$200	
Phone/Internet	$150	
Car Insurance	$100	
Groceries	$500	
Misc. Spending	$450	
Total Costs		$4,248
Savings		$752

IV. Conclusion

Based on my findings, I would still enjoy starting my career in either city. However, I would prefer Seattle. The population and crime, when compared to Chicago is much lower. The climate is more suited to what I am looking for with cooler summers, as well as the mountainous geographical profile. The size of the apartments for the price is also slightly bigger. When considering recreational activities, Seattle also has more nature centered activities, which I enjoy, than Chicago. Overall, both seem to be interesting, vibrant cities that I could see myself in.

CASE 6: CAPITALIZATION V. EXPENSING

WorldCom

8 November 2018

I. Introduction

This case looked at the improper accounting methods used by WorldCom to capitalize costs that should have been expensed. In 2001, WorldCom treated “line costs,” which are charges from paying local telephone networks to complete calls, as capital expenditures. This resulted in the company stating profitability for the year, rather than a multimillion-dollar loss. Accurate financial statements and view of a firm’s health are vital to a user’s decision making. Overall, the case allowed me to see real transactions that negatively, or positively if you are WorldCom, affect net income. The case also stressed the importance of using proper accounting procedure, because doing so establishes trust with users that is not easily earned back.

II. FASB Statement of Concepts No. 6

A. Explain, in your own words, how SCON 6 defines “asset” and “expense.”

Assets are future economic benefits derived from past transactions and events. Expenses are the outflows of assets or incurrence of liabilities from providing a good or service or other activity that relates to the entity’s core operations.

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

If a cost will provide a future benefit, such as a prepaid insurance plan, the cost should be recorded as an asset on the balance sheet and capitalized over a period of time. If a cost will provide value only once, the cost should be expensed on the income statement.

III. Costs After Initial Capitalization

After the initial capitalization of a cost, the asset on the balance sheet the cost was recorded as will decrease by the amount capitalized. The income statement will show an expense incurred for the amount capitalized.

IV. WorldCom's Line Costs

WorldCom reported line costs of $14,739,000,000 for the year ended December 31, 2001. The journal entry for these transactions would be as follows:

Line Cost Expense	14,739,000,000	
Accrued Liability		14,739,000,000

Line costs, which make up almost half of WorldCom's expenses, are incurred from their daily operations. Providers, outside of the company, were paid for access to their services and to transport calls globally. In 2001, WorldCom intentionally and incorrectly accounted for a large portion of these expenses in a capitalization account.

V. Improperly Capitalized Costs

The costs that were improperly capitalized, according to the Wall Street Journal article, were charges for completing calls paid to local telephone networks, known as "line costs," in the amount of $3.8 billion. Transactions that would give rise to these costs would be a lease or contract for WorldCom to use the local providers' networks.

These do not meet the definition of assets previously stated in part a, because no future benefit is gained.

VI. Journal Entry for Improperly Capitalized Costs

The incorrect journal entry to record the improperly capitalized line costs would be as follows:

PPE	3,055,000,000	
Line Cost Expense		3,055,000,000

These costs appeared on the balance sheet in the "Property and Equipment" account. They did not appear on the statement of cash flows and would not until they had been capitalized as depreciation.

VII. Depreciation Calculation

To calculate depreciation, the midpoint of 22 years was used, and each quarter was adjusted for partial years.

1st Quarter:	771/22 x 4/4 = $35,045,455
2nd Quarter:	610/22 x 3/4 = $20,795,455
3rd Quarter:	743/22 x 2/4 = $16,886,364
4th Quarter:	931/22 x 1/4 = $10,579,546
Total Depreciation:	$83,306,820

The journal entry would be as follows:

Depreciation Expense	83,306,820	
Accumulated Depreciation		83,306,820

VIII. Net Income if Properly Recorded

Income Before Tax, as reported	$2,393,000,000
Add: Improper Depreciation Expense	$83,306,820
Less: Capitalized Line Cost Expense	$3,055,000,000
Income (Loss) Before Tax, Restated	($578,693,180)
Income Tax Benefit	$202,542,613
Minority Interest	$35,000,000
Net Income	($341,150,567)

The difference is material. WorldCom stated they had a billion-dollar net income, instead of a multimillion-dollar loss.

CASE 7: COMMON SIZE ANALYSIS

Starbucks Corporation

3 March 2019

I. Introduction

This case examined Starbucks Corporation's financial statements and their auditors' opinion letters. In groups of two to three students, common size analyses of the balance sheet and income statement were created to compare data across years. This allowed students to gain a better understanding of Starbucks' financial position. The last step of this case was to review the statement of cash flows. By comparing this report to the other financial statements, students defined the difference between net earnings and net cash provided. Common size analyses, which look at financial data across years and categories, allow users to evaluate the long-term health of a company, and are, thus, extremely important to the business world.

II. Common Size Income Statement

In Millions, except Per Share data, unless otherwise specified	Sep. 29, 2013	Sep. 30, 2012	Common Size 2013	Common Size 2012
Net revenues:				
Company-operated stores	$11,793.20	$10,534.50	**79.19%**	**79.21%**
Licensed stores	1,360.50	1,210.30	**9.14%**	**9.10%**
CPG, foodservice and other	1,738.50	1,554.70	**11.67%**	**11.69%**
Total net revenues	14,892.20	13,299.50	**100.00%**	**100.00%**
Cost of sales including occupancy costs	6,382.30	5,813.30	**42.86%**	**43.71%**
Store operating expenses	4,286.10	3,918.10	**28.78%**	**29.46%**
Other operating expenses	457.2	429.9	**3.07%**	**3.23%**
Depreciation and amortization expenses	621.4	550.3	**4.17%**	**4.14%**
General and administrative expenses	937.9	801.2	**6.30%**	**6.02%**
Litigation charge	2,784.10	0	**18.70%**	**0.00%**
Total operating expenses	15,469	11,512.80	**103.87%**	**86.57%**
Gain on sale of properties	0	0	**0.00%**	**0.00%**
Income from equity investees	251.4	210.7	**1.69%**	**1.58%**
Operating income	-325.4	1,997.40	**-2.19%**	**15.02%**
Interest income and other, net	123.6	94.4	**0.83%**	**0.71%**
Interest expense	-28.1	-32.7	**-0.19%**	**-0.25%**
Earnings before income taxes	-229.9	2,059.10	**-1.54%**	**15.48%**
Income taxes	-238.7	674.4	**-1.60%**	**5.07%**
Net earnings including noncontrolling interests	8.8	1,384.70	**0.06%**	**10.41%**
Net earnings attributable to noncontrolling interest	0.5	0.9	**0.00%**	**0.01%**
Net earnings attributable to Starbucks	$8.30	$1,383.80	**0.06%**	**10.40%**

III. Common Size Balance Sheet

In Millions, unless otherwise specified	Sep. 29, 2013	Sep. 30, 2012		Common Size 2013	Common Size 2012
Current assets:					
Cash and cash equivalents	$2,575.70	$1,188.60		**22.36%**	**14.46%**
Short-term investments	658.1	848.4		**5.71%**	**10.32%**
Accounts receivable, net	561.4	485.9		**4.87%**	**5.91%**
Inventories	1,111.20	1,241.50		**9.65%**	**15.10%**
Prepaid expenses and other current assets	287.7	196.5		**2.50%**	**2.39%**
Deferred income taxes, net	277.3	238.7		**2.41%**	**2.90%**
Total current assets	5,471.40	4,199.60		**47.51%**	**51.09%**
Long-term investments	58.3	116		**0.51%**	**1.41%**
Equity and cost investments	496.5	459.9		**4.31%**	**5.60%**
Property, plant and equipment, net	3,200.50	2,658.90		**27.79%**	**32.35%**
Deferred income taxes, net	967	97.3		**8.40%**	**1.18%**
Other assets	185.3	144.7		**1.61%**	**1.76%**
Other intangible assets	274.8	143.7		**2.39%**	**1.75%**
Goodwill	862.9	399.1	[1]	**7.49%**	**4.86%**
TOTAL ASSETS	11,516.70	8,219.20		**100.00%**	**100.00%**
Current liabilities:					
Accounts payable	491.7	398.1		**4.27%**	**4.84%**
Accrued litigation charge	2,784.10	0		**24.17%**	**0.00%**
Accrued liabilities	1,269.30	1,133.80		**11.02%**	**13.79%**
Insurance reserves	178.5	167.7		**1.55%**	**2.04%**
Deferred revenue	653.7	510.2		**5.68%**	**6.21%**
Total current liabilities	5,377.30	2,209.80		**46.69%**	**26.89%**

Common Size Balance Sheet Continued…

	Sep. 29, 2013	Sep. 30, 2012	Common Size 2013	Common Size 2012
Long-term debt	1,299.40	549.6	**11.28%**	**6.69%**
Other long-term liabilities	357.7	345.3	**3.11%**	**4.20%**
Total liabilities	7,034.40	3,104.70	**61.08%**	**37.77%**
Shareholders' equity:				
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0.8	0.7	**0.01%**	**0.01%**
Additional paid-in capital	282.1	39.4	**2.45%**	**0.48%**
Retained earnings	4,130.30	5,046.20	**35.86%**	**61.40%**
Accumulated other comprehensive income	67	22.7	**0.58%**	**0.28%**
Total shareholders' equity	4,480.20	5,109	**38.90%**	**62.16%**
Noncontrolling interests	2.1	5.5	**0.02%**	**0.07%**
Total equity	4,482.30	5,114.50	**38.92%**	**62.23%**
TOTAL LIABILITIES AND EQUITY	$11,516.70	$8,219.20	**100.00%**	**100.00%**

IV. Revenue Source

Starbucks is a well-known coffee shop with stores that range across the U.S. and the world. While they do have some merchandise for sale in their store fronts, they are mainly providing a service for their customers. Revenue comes from a variety of sources. The first is selling beverages and food items at company-operated stores. Starbucks also reports income from royalties and franchising fees. Licensees pay to use the Starbucks brand. Lastly, the company makes money from selling branded products to grocery, warehouse clubs, such as Sam's, and specialty retail stores.

V. Starbucks's Financial Reporting

The four main financial statements created for external use are the income statement, balance sheet, statement of retained earnings, and statement of cash flows. Starbucks prepared all of these statements with slightly differing names. The company also included an extra financial sheet. The five statements were Consolidated Statement of Earnings, Comprehensive Income, Balance Sheet, Cash Flows, and Equity. Consolidated means that all aspects of a parent company and its subsidiaries are reported as a single entity. This type of accounting is done when a company owns more than 50% of another entity. Publicly traded companies, such as Starbucks, are required to prepare external financial statements quarterly. The quarterly reports are referred to as 10Q reports, while required annual reports are called 10K reports.

The management of the corporation is responsible for creating financial statements and ensuring faithful representation of the financial condition. This would include the

CEO, CFO, and other key players in the financial department. Users of the external financial statements reported by Starbucks are most likely investors and lenders. Investors are interested in the corporation's performance, because it informs their decisions regarding whether they should keep shares of ownership, should they sell, or should they purchase more. Lenders desire information about Starbucks' ability to pay back debt and the length of time it will take.

VI. Auditor's Opinion

Starbucks is externally audited by Deloitte and Touche, LLP. The first opinion letter describes Deloitte and Touche, LLP's role, what an audit of the financial statements consists of, and what policies and standards are followed. This opinion also stated that they believe Starbucks faithfully represented their financial position. The second opinion letter from Deloitte states the findings of their audit of Starbucks's internal control over financial reporting. Deloitte believed Starbucks executed and maintained proper control over reporting during the time period audited. Each of these opinions is an assurance from an unbiased source of reliability and faithful representation of Starbucks's financial statements to the potential users. They are dated several months after the year-end, because after the financial statements are produced, external auditors need considerable time to review the reported information so as to provide reasonable assurance.

VII. Assets and Debt-to-Equity

The two major assets of Starbucks corporation are cash and cash equivalents and PP&E. Short term assets make up 47.51% of total assets, while long term assets are 52.49%. The ratio of short term to long term is almost a one-to-one ratio. This is an appropriate level for Starbucks. Intangible assets, in general, include items such as copyrights, patents, brand recognition, intellectual property, and goodwill. Goodwill is the difference between purchase price and fair value as a result of the acquisition of another entity. For Starbucks, specific intangible assets include brand recognition and customer loyalty.

A company can be financed in one of two ways: debt or equity. So, we use the debt-to-equity ratio to calculate the amount of debt Starbucks is taking on to finance in comparison to equity.

Total Liabilities/ Total Equity	\$7,034.40/\$4,482.30 =1.57

Since the debt-to-equity ratio is greater than one, this tells us that Starbucks has been taking on more debt than equity to finance its endeavors. Percent of financing from non-owners is equal to liabilities and is calculated by dividing total liabilities by total assets. Conversely, financing from owners is calculated by dividing total equity by total assets.

% of financing: Non-Owners	\$7,034.40/\$11,516.70 =61.08%
% of Financing: Owners	\$4,482.30/\$11,516.70 =38.92%

VIII. Revenue and Expense Recognition

Starbucks Corporation uses both the cash basis and accrual accounting methods. For company owned stores, Starbucks records revenue as soon as they receive cash from the customer. Licensee stores follow the accrual accounting procedure. After stored value cards, otherwise known as a gift card, are purchased, revenue is recorded when redeemed or the likelihood to redeem is remote. These stored value cards can create a revenue recording challenge, because customers' accounts and unredeemed stored value cards fluctuate in balance causing inconsistency. Also due to the nature of Starbucks' activities, a small of amount loss is expected from unsold food and coffee.

Some of Starbucks' major expenses include cost of sales, occupancy costs, and store operating expenses. The other major expense for 2013 is the litigation expense. The year 2012 did not have this expense. Certain costs were previously allocated at a segment level of operating expenses, are now managed by corporate level managers and are not allocated to operating expenses but corporate expenses. The litigation expense was only incurred in 2013. Since this expense was not a common, recurring expense which is what is typically falls under general and administrative expenses. Profitability is the ability to generate revenues greater than the expenses needed to produce these sales. Based on this definition, Starbucks Corporation was not profitable in 2013 but was in 2012.

IX. Cash Flow

Starbucks' net earnings for 2013 was $8.8 million. The net cash provided by operating activities was $2,908.3 million in 2013. Net earnings are the revenues in a reporting period less the expenses for the same period. Net cash, on the other hand, is net earnings adjusted for noncash expenses such as depreciation or a gain. In 2013, Starbucks Corporation invested $1,151.2 million in cash in property, plant, and equipment. In 2013, dividends of $668.6 million were declared according to the Statement of Equity. However, only $628.9 million in dividends were paid in cash.

X. Estimated Accounts

A. Accounts that Use Estimates:

Intangible Assets

Goodwill

Accrued Litigation Charge

Insurance Reserves

Deferred Revenue

Additional Paid in Capital

B. Accounts that Do Not Use Estimates:

Cash

Inventory

Prepaid Expenses

CASE 8: CONTINGENCIES

BP plc.

2 April 2019

I. Introduction

As someone who grew up going to Gulf Shores, AL, a city deeply affected by the Deepwater Horizon oil spill, at least twice every summer, this case explores a topic I heard about frequently but never quite understood. The case itself discusses contingent liabilities, which affect every business at some point during their operations, in the context of British Petroleum and the oil spill caused by an explosion on a rig leased and operated by the firm. This oil spill wreaked havoc on tourism along the Gulf Coast, hitting businesses and individuals hard after a tough recession two years prior.

Exploring this case allowed me to glean more knowledge on a subject close to home, as well as new knowledge on how to report potential liabilities and assets in the financial statements. However, one risk factor for BP includes not estimating high enough contingent liabilities. While some businesses such as restaurants and fishing companies are obvious sources of potential losses from lawsuits, British Petroleum should have included all in their estimate from even the most unconventional sources like the shops at the Wharf, a concert venue near the coast, or the wind-surfing company.

The knowledge gained from this case will carry through to my career in accounting and law, because I will be able to see the case from both perspectives. I will understand what risks the company may face due to accidents and mistakes, as well as the decision-making process in deciding what is a likely risk and what is not. Lastly, I now understand that contingencies do not just have to be liabilities which result in losses but can also be future assets.

II. Contingent Liability

A contingent liability is a loss that may or may not occur depending on the outcome of an uncertain series of events. In the accounting industry, a contingent liability is recorded on the books of the entity if the contingency is likely to occur and the amount of liability to be incurred by the entity if the contingency comes to fruition can be reasonably estimated. If neither of these stipulations are met, the contingency does not have to be disclosed at that time. Some contingent liabilities companies might record include product warranties, potential lawsuits, or pending government investigations.

On the other hand, a contingent asset is a gain that may arise from events unknown and outside of the organization’s control. Unlike contingent liabilities though, businesses do not report contingent assets on the balance sheet until they are realized, no matter how likely. Under GAAP, the conservatism principle, which states that uncertain outcomes should be reported in a way that shows the lowest possible profit, overrules the matching principle. However, contingent assets should be disclosed on the notes to the financial statements.

III. Product Warranty: Seller and Customer Viewpoints

A product warranty is a promise by the seller, in this case GE Oil and Gas, to fix or exchange a product if the product were to break during the time period specified in the warranty guidelines. On the books of GE Oil and Gas, the product warranty for a telescopic joint sold to BP would be considered a contingent liability, because the company may have to pay to repair or replace the item in the next two years. Having to do so would cause a loss to GE Oil and Gas. However, for British Petroleum, the product warranty is considered a contingent asset, based on the aforementioned definition in part two. If BP were to file a warranty claim against GE Oil and Gas, the product would be fixed without cost to BP resulting in a gain.

IV. Judgements by Management

Management must make many judgement calls regarding contingent liabilities, because the results of the events affecting the liability are uncertain. Companies must make predictions and guesses based off of prior experience and the likelihood of outcomes. Some of these decisions include how much liability to report on the financial statements. Should the company report more or less? Management must decide, specifically for warranty costs, what repairs are covered, when do the costs of repairs fall on them as the seller or on the buyer. However, a product warranty claim on an item such as telescopic joint and the damages claim from the Deepwater Horizon oil spill differ greatly. This is because a company knows how much certain repairs cost and what they are responsible for. In the case of British Petroleum, the facts are not as clear cut. Someone must judge how much of the damage British Petroleum was responsible for. Did they cause the loss in tourism across the Gulf Coast, or are the environmental damages to the beaches and surrounding waters the only effects directly caused by the oil spill?

V. British Petroleum's Estimates

The list of estimates British Petroleum must make due to the oil spill is long and taxing. One estimate would be the cost of repairs the company must perform on the oil rig. The amount BP must spend to clean up the oil is another valuation of a possible liability they will have. Sadly, they also must estimate the amount of life insurance and other expenses to be paid to the families of the deceased because of the accident. Lastly, they should also estimate the amount of litigation costs. Investigations and trials that occur after an oil spill similar to Deepwater Horizon can take years, racking up tremendous amounts of court costs and legal fees.

VI. What is Reasonable?

As an auditor for British Petroleum, I would have to assess what is a reasonable estimate of costs and who can or cannot sue. I believe everyone that lives or owns a business or property on the Gulf Coast should not be able to sue the company. Tourism took a large dip due to the oil spill, so any business related to the tourism industry has reasonable reason to sue. However, while the environmental damages were catastrophic, not every organization devoted to cleaning up the Gulf Coast beaches has enough stake in the accident to sue. Also, while some businesses were closed to profit loss, some were more affected by the recession and cannot use the oil spill as a scapegoat to receive potential benefits. As such here is a list of potential businesses and individuals that could reasonably sue British Petroleum:

- Fishing Companies
- Hotels
- Restaurants
- Tourist Shops and Attractions
- Waterparks

CASE 9: EQUITY METHOD INVESTMENTS

Wendy's Company

9 April 2019

I. Introduction

Currently, I am taking a course in advanced accounting. This course covers many different topics, with considerable time spent on consolidations of business entities and how to account for these transactions. While previously I understood most of the concepts in the material, I now have a firm grasp on the practical application of the equity method concerning investing in a company by purchasing equity.

The Wendy's Company partnered with Tim Hortons Inc in a joint venture to reach a broader market, specifically Canada. This provided both companies with the opportunity to gain more profits by combining knowledge, skills, and capital. However, the case raised a question for me regarding their mutually beneficial project. Since joint ventures, in their very nature, are nonpermanent contracts to be dissolved at a specific time, how are the one hundred and five combination restaurants divided between the two business entities? Unlike some joint ventures, where at the end of the project the only item needed to be split between the beneficiaries is debt or profit, the companies must determine how to deal with tangible assets that are not as easily divided.

No matter the questions I now have regarding the equity method of accounting, I have learned valuable information I will be able to apply in my future career. The case required me to study consolidated financial statements and learn to pick out essential figures. I also am able to look at the notes to the financial statements and interpret their meaning with clarity. Previously, I had only been taught through books and word problems with the crucial information laid out.

II. Joint Venture Agreements

A joint venture is used as an alternative to a merger or acquisition and is the contractual agreement of two or more companies to work as partners and pool resources on a specific project for a specified amount of time. Companies participating in a joint venture derive many mutual benefits from the agreement. One such advantage is shared resources. Many times, companies enter into a joint venture because of lack of capital, knowledge, technology, or customer market. A joint venture with another company with different strengths allows for the sharing of resources without costly expenditures.

Another benefit to joint ventures is the flexibility, especially compared to more permanent business strategies. The contract states an exact date the partnership dissolves, and no new business entity must be created to complete the project, allowing participating companies to return to normal operations easily.

Lastly, not only do companies involved in joint ventures share in the profits of finished projects, they share in the risks and losses. While the creation of a new product or service tends to hold a great deal of risk for individual companies, a joint venture distributes the risk between participants, lowering the impact on profitability if the project fails.

III. Equity Method

The equity method is an accounting procedure used by parent companies to assess the profits earned by their investments in subsidiary companies. This technique is used when investments of twenty percent or greater are made in a different entity. The initial investment in the subsidiary is recorded at cost in an equity investment account, as shown below.

Equity Investment in Company XYZ	XXX	
Cash		XXX

After the initial investment is recorded, the parent's investment account is adjusted to reflect the changes in their share's value periodically. Two types of adjustments can be made based on the subsidiary's income and dividends. After a subsidiary reports income for the period, the parent company will adjust for this as an increase in their equity investment and an increase in investment income. The journal entry is as follows:

Equity Investment in Company XYZ	XXX	
Investment Income		XXX

The other adjustment is due to dividends. Since dividends represents the company paying out a certain amount to investors, this leads to a decrease in the investment account and an increase in the cash account, as demonstrated in the journal entry below.

Cash	XXX	
Equity Investment in Company XYZ		XXX

One other change to the investment account that can be made is an adjustment for amortization and depreciation expenses on assets whose fair value is in excess of book value at the time of investment. This journal entry will be discussed in the subsequent section.

IV. Excess of Investment Over Net Assets

When a company makes an investment in another company by purchasing shares, the investment amount, or fair market value, may sometimes exceed the book value. Book value, otherwise known as net assets, can be found by subtracting the liabilities from the assets. The value of the net assets is also equal to the equity section of the balance sheet. When this phenomenon occurs, the first step for the parent company is to allocate a portion of the over amount to undervalued identifiable assets and liabilities and write them up to fair value. Since the subsidiary still has the assets and liabilities on the books at a lower amount, the parent company must record the depreciation and amortization of the allocated amount each year. The expense from doing so affects the equity investment account and the investment income account, as shown below.

Investment Income	XXX	
Equity Investment		XXX

After the allocation to identifiable undervalued assets and liabilities, the remainder of the excess of investment value over book value is recognized as goodwill. Goodwill is an intangible asset associated with the subsidiary's reputation, customer base, brand name, etc. Unlike the assets and liabilities written up to fair value that must be amortized or depreciated, goodwill must be checked for impairment periodically. If goodwill is found to be impaired, the value lowered. However, goodwill is never increased.

The allocation of excess value to goodwill is not included in a journal entry but included in the amount attributed to the equity investment account. When consolidated balance sheets are prepared, worksheet elimination entries are made to accurately represent, not only goodwill, but the undervalued assets and liabilities previously mentioned as well.

V. Note 8 of Wendy's Company Financial Statements

On Wendy's financial statements, specifically the balance sheet, two equity method investment accounts were listed: Joint Venture with THI (Tim Hortons Inc) and Joint Venture in Japan. The carrying value of each account balance are detailed below (in thousands).

JOINT VENTURE	YEAR END 2012	YEAR END 2011
TIM HORTONS INC	$89,370	$91,742
JAPAN	($1,750)	$77

These amounts appear on Wendy's consolidated balance sheet in the Investments account, along with the cost method investments, including Arby's and Jurlique. While, the account balance for THI was a normal balance, the investment in Japan was not.

The negative account balance could be due to a net loss in income by the subsidiary or depreciation and amortization expenses from written up assets and liabilities.

VI. Difference in Investment and Equity Accounts

At December 31, 2012, Wendy's investment in TimWen is recorded at $89,370. On the same date, Wendy's fifty percent share of TimWen's equity was valued at $35,283. This sizeable difference in accounts can be explained by the acquisition accounting premium, which is the excess of the investment value over book value that was allotted to written up assets and goodwill.

VII. Wendy's Equity Method Journal Entries for TimWen Investment

Wendy's equity method investment in TimWen decreased their earnings before taxes in 2012 and 2011, because based on Note 8 of the financial statements, the equity in earnings for TimWen was buried in "Other operating expense, net" on the statement of operations. The journal entry to record Wendy's share of TimWen's 2012 earnings would be as follows (in thousands):

Equity Investment in TimWen	13,680	
Investment Income		13,680

The journal entry to adjust the equity investment account for amortization of purchase price adjustments for 2012 in the amount (in thousands) of $3,129 is shown below.

Investment Income	3,129	
Equity Investment in TimWen		3,129

Wendy's also received a portion of dividends in 2012 for their fifty percent share of TimWen, again shown in thousands, valued at $15,274. Below is the journal entry to show the receipt of these dividends and their effects on the equity investment account.

Cash	15,274	
Equity Investment in TimWen		15,274

VIII. Statement of Cash Flows

In the operating activities section of the statement of cash flows, Wendy reports a negative adjustment for "Equity in earnings in joint ventures, net" in the amount of $8,724 (in thousands) for the year 2012. This adjustment is made because earnings in equity and depreciation for TimWen and the joint venture in Japan are noncash transactions. As such, their effect on net income must be eliminated. The reconciliation is as follows, shown in thousands:

Equity in Earnings for the period, TimWen	(13,680)
Equity in losses for the period, Japan	1,827
Amortization of purchase price adjustments, TimWen	3,129
Equity in earnings in joint ventures, net	8,724

The operating section also shows a positive adjustment for "Distributions received from joint venture." Since dividends are a cash transaction, and Wendy's received the amount stated, while this does not affect the income statement, cash flows are affected and must be reported as such.

CASE 10: RETIREMENT OBLIGATIONS

Johnson and Johnson

13 April 2019

I. Introduction

As someone who has grown up hearing about the future demise of social security, pension, or retirement, plans are an important topic to my personal financial security. In my professional life as an accountant, this is also an important issue for many companies and government entities who provide after-employment benefits. After-employment benefits are listed as liabilities on the sponsoring entity's balance sheet because of the debt owed to the employee after retirement. However, they can be used as a tool to attract and keep the top talent in the industry. Employees are less likely to leave if they believe the company they work for is also contributing to their future.

As such, this case allowed me the opportunity to examine a factual pension plan memo and link balance sheet and income statement accounts to the memo. In my future career, I will be able to more easily recognize these features when presented with a client's financial statements. Not only was I able to connect the financial statement aspects, but I was able to better grasp the logic behind pension expense, plan assets, and benefit obligations by diagramming a flow chart. Now instead of assuming cash was paid by the company to the retiree when the time came, I know the management company pays the retiree, and the sponsoring company only decreases plan assets and benefit obligations. Overall, I have a firm grasp on the concept of retirement plans and the accounting procedure behind them.

II. Two Types of Retirement

Two general types of retirement, or pension, plans exist: defined benefit plan and defined contribution plan. A defined benefit plan is a program sponsored by the employer where benefits are calculated using a predetermined formula based on several factors, such as length of employment and salary history. Restrictions on this plan exist for the employees on when and how they can withdraw funds as to not incur penalties. In this type of retirement plan, the employer bears all the risk of investment and must use company funds to pay if the return on investment falls short of obligations.

The other type of pension plan is the defined contribution plan. In a defined contribution plan, employees contribute a fixed amount or percentage of their paychecks, and the employer usually matches a portion of this amount. In this plan, the employer and employee share the risk of investment. Unlike the defined benefit plan, this plan does not guarantee a set benefit at a certain date, because contribution levels and returns may change over the years. However, one advantage of this plan is tax-deferment of contributions.

The company discussed in this case, Johnson and Johnson, sponsors both defined benefit and defined contribution plans, as well as other postretirement benefits like health care for retired U.S. employees and dependents. These retirement plan obligations are recorded as liabilities on the sponsoring company's books. The definition of a liability states any future expense or obligation arising from past business transactions is a liability. Since, retirement plan obligations are what a sponsoring company owes an employee for the work they did previously, and the amount owed will be paid at some point in the future, these obligations meet the definition of a liability. Refer to Figure 1 to visualize the flow of cash from the sponsoring company to the pension plan management company to the retiree.

Sponsoring companies must also make many assumptions to account for retirement plan obligations. One necessary assumption is the expected return on investments. Other conjectures that must be made regarding the employee include length of employment, future salary, and life expectancy after retirement.

III. Pension Obligation Influences

Four main activities influence a company's pension obligations: service cost, interest cost, actuarial gains or losses, and benefits paid to retirees. The first activity, service cost, is the amount of retirement benefits earned by employees participating in the plan during the current period. This activity increases a company's pension expense for the period, which in turn increase pension obligations.

Another activity associated with pension obligations is interest cost. Projected benefit obligations, PBO, are recorded in terms of present value. Since, each year, employees are one year closer to retirement, the sponsoring company incurs an interest cost equal to the discount rate used to state the PBO at present value multiplied by the beginning PBO for the period. Interest costs related to pension plans also increase pension expense and pension obligations.

Actuarial gains or losses can increase or decrease the company's obligations depending on the situation. This activity arises from adjustments to actuarial assumptions, which are used to value projected benefit obligations.

IV. Plan Assets Influences

Plan assets are influenced by three major activities: the actual return on pension investments, the sponsoring company's contributions to the plan, and benefits paid to retirees. Plan assets are increased by the actual return on pension investments. This is the amount a sponsoring company earns on its investment each year and increases available funds to pay obligations arising from pension plans. Sponsoring company's contributions also increase the plan assets, because the company is adding more funds to the available amount to pay obligations. The benefits paid to the retiree, however, decrease plan assets, because funds are being used to fulfill the retirement plan obligation.

V. Difference in "Return on Plan Assets"

Both pension expense and pension plan accounts have a "return on plan assets" component. However, the amounts in these returns differ slightly due to the fact that the component of pension expense is the expected returns on assets, and the addition to the plan assets is the actual return on assets. For Johnson and Johnson in 2007, the expected return was $809 million, and the actual return was $743 million. The reason the two numbers differ is because the expected return is an estimate at the beginning of the year of what the sponsoring company budgets their investment to make. The actual return is what the investment actually makes over the year.

VI. Johnson and Johnson's Pension Expense

On the 2007 income statement, based on Note 13 of the financial statements, Johnson and Johnson reported $646 million in pension expense, otherwise noted as "net periodic benefit cost." The journal entry to record the service and interest cost portion of pension expense is as follows, in millions:

Pension Expense	1,253	
Projected Benefit Obligations		1,253

VII. Johnson and Johnson's Retirement Plan Obligation

On December 31, 2007, Johnson and Johnson's retirement plan obligation was $12,002 million. This value represents the amount of benefits Johnson and Johnson owes to its employees at some point in the future. This estimate is a reasonably reliable value.

The pension related interest cost, included in the aforementioned value, is $656 million, as stated in Note 13. This interest expense is determined by multiplying the beginning projected benefit obligation, plus any new prior service cost amendments, by the settlement rate. The same formula can be manipulated to solve for the settlement rate if provided with the beginning PBO and interest cost, as is the case with Johnson and Johnson. Below is the manipulation of the previously mentioned formula and calculation of the settlement rate used by Johnson and Johnson in 2007, 5.619 percent.

(beginning PBO + new PSC amendment) x settlement rate = interest cost

settlement rate = interest cost / (beginning PBO + new PSC amendment)

settlement rate = 656 / (11,660 + 14)

settlement rate = 656 / 11,674

settlement rate = 5.619%

This rate seems reasonable, because the rate is between the discount rates listed in the table in Note 13 for U.S. benefit plans and international benefit plans. During the year 2007, $481 million of pension benefits was paid to retirees. However, this amount is not paid in cash by Johnson and Johnson. Instead, the pension plan management company pays the retired employees, and Johnson and Johnson decrease both retirement plan obligations and retirement plan assets on its books. This is because the amount owed to previous employees and the amount available to meet future obligations decreases.

VIII. Johnson and Johnson's Retirement Plan Assets

The retirement plan assets for Johnson and Johnson on December 31, 2007 were valued at $10,469 million. This value is the amount Johnson and Johnson had held by the pension plan management company to cover its obligations to its retirees. One component of plan assets that contributes to the difference from projected benefit obligations is the actual return. In 2006, the actual return was $966 million, while the expected return was only $701 million. This is a significant favorable difference. During the year 2007 however, the actual return on Johnson and Johnson's investment was $743 million, but the expected return was $809 million. While this difference was less significant and overall, unfavorable, the 2007 return better represents the economics of the company's pension expense. The estimate used in 2007 was closer in value to the actual return, providing a more accurate pension expense. In 2006, the expected return was much lower than the actual return, producing a higher pension expense than actually incurred during the year.

In 2007, Johnson and Johnson and its employees contributed $317 million and $62 million, respectively, for a total of $379 million. This is much greater than the amount contributed by both parties in 2006, where the company gave $259 million and employees gave $47 million, totaling to $306 million. These contributions were put into both debt and equity securities to fund the retirement plans.

IX. Funded Status of Johnson and Johnson's Pension Plan

Sponsoring company's retirement plans tend to be either overfunded or underfunded. If overfunded, this means the company has more in pension plan assets than in pension plan obligations. The opposite is true of underfunded. The company has more pension plan obligations than plan assets. In the case of Johnson and Johnson on December 31, 2007 and December 31, 2006, the pension plan was underfunded. This amount can be seen on the balance sheet as "employee related obligations."

CASE 11: BALANCE SHEET BASED MODEL

Article Analysis

27 April 2019

I. Introduction

The University of Mississippi's accountancy school is one of the most rigorous programs in the country. As such, we still teach and follow the balance-sheet approach of accounting, never learning anything else. This article forced me to consider an alternative, that in my mind made much more sense given what I know about how a business is run.

In high school, I worked at a small boutique in my hometown. Our main inventory was clothing, as such this would most likely be counted as our only asset. However, if you were to take away the goal of selling the clothes to produce a profit, these clothes would no longer be counted as an asset, but just dead weight. However, according to the balance sheet approach, the clothing is more important than the revenue being supported by this asset. In high school, I did not know the proper accounting procedure that would be used to report the financials for this business. I now do.

As such, the current method, as Columbia Business School's Center for Excellence in Accounting and Security Analysis stated does not accurately reflect what the goal of that business and its employees was. In the future, I may be hesitant to use fair value method over the historical cost method. As explained in the article, the fair value method tends to inextricably link the real economy and financial markets, never separating the two, which could lead to a market bubble, as seen in 2008. Overall, I was enlightened by the unpopular viewpoint presented by the researchers and hope to continue use what I have learned in my studies hand in hand with this knowledge.

II. Article Summary

The Columbia Business School's Center for Excellence in Accounting and Security Analysis, hereafter referred to as CEASA, studied the implications of the FASB and IASB's debate on the accounting conceptual framework and detailed what they perceived to be a vital reconsideration missing from the project. The article begins with an overview stating the current balance sheet-based model for financial accounting is flawed and listing four main arguments, which include:

1. Accounting is meant to reflect business reality, which is to advance expenses to earn revenues. The balance sheet approach does not do so.
2. The current model inherently says assets are more fundamental than income and logically are valued prior. CEASA argues income is clearer and more useful value than balance sheet accounts.
3. Earnings is the most important output of the accounting system, and expansion of the balance sheet approach hinders the future usefulness of earnings through asset revaluations.
4. The balance sheet-based model has pushed more reliance on estimates, creating a dangerous loop between financial markets and the real economy.

Each of these themes was then discussed more in-depth at a later point in the academic paper. The article also provided two possible solutions for "good" models for financial reporting, creating a sharp distinction between operating and financing activities and assets and a renewed emphasis on matching expenses to revenues.

After the overview, CEASA provided a detailed history of the two competing approaches, the balance sheet approach and the income statement approach. The balance sheet approach, as outlined by CEASA, defines proper valuation of assets and liabilities as the primary goal of financial reporting. This goal implies income and earnings are subject to considerations from the balance sheet. On the other hand, the income statement approach sets the primary goal as determinations of revenues, expenses, and earnings. The two guiding principles of this approach are revenue recognition and matching of expenses to revenues. Historically, financial accounting and reporting has been a compromise of the two approaches, where the income statement-based model dominated the landscape until the 1970's. At this point in time, the FASB was formed and began its reign as the standard setter for the U.S. and eventually the international scene.

At its conception, the FASB realized piecing together the two approaches would lead to inconsistencies in reporting. So, after extensive research, the FASB decided balance sheet accounting was the only logical basis and should be the "cornerstone of standard setting." According to the article, FASB based their reasoning on a few main points. First, earnings are a "change in value" concept which is impossible to define until "value" is defined. Also, FASB believed the income statement approach relies on vague concepts making the model suspect by creating deferrals and accruals which are assets and liabilities of questionable substance.

After the FASB came to their decision of what approach was appropriate, they continued to expand and solidify the balance sheet-based model. First, older rules gradually were transitioned to conform to and support the new framework. The FASB also adopted more extreme forms of the balance sheet model, such as fair value accounting. They also expanded geographically by influencing accounting systems on the international stage. Lastly, to solidify the new framework, the FASB issued the Preliminary Views document in 2006. This document outlined indications of what the future framework would look like, specifically a less significant view of earnings.

CEASA moved from a background and history of the two approaches to a more in-depth discussion of the four main critiques they had of the balance sheet approach previously listed. The first critique looked at was the argument that the balance sheet approach is at odds with how most businesses operate and create value. Most businesses continually advance expenses to earn revenue. Assets are mainly acquired to support this goal and have little value independent of the goal. The writers of the article called most assets, “asset furnaces”, sacrificed to generate earnings. One example given of this was the trading guilds of the Middle Ages. If what was just stated is true, then proper accounting should reflect this, and CEASA believes this implies a logical supremacy of the income statement-based model.

CEASA also pointed out that most businesses when making predictions and management decisions look at a forecast of revenues first, then a prediction of costs to support the forecasted revenue, and lastly, an asset base needed for revenues and expenses. Also, investors, who are the most important users of the financial reporting, and financial analysts look at income statements and revenue/expense projections. Rarely do they reference a projection of the balance sheet. One of the researchers most explanatory statements on this critique was “a firm is a process and not a collection of ‘things.’” In turn, this implies that the income statement approach is the natural foundation of financial reporting. The CEASA's article also provided research in the form of a table and graph to provide evidence about "the relative roles of internal use versus market-based considerations for PPE." They listed aggregate stocks and flows of U.S. firms', with total assets exceeding $50 million, PPE over fifteen years. The hypothesis was capital expenditures increase the level of PPE held by a firm and depreciation and sales of PPE reduce the level of PPE. Their review of the table and graph showed two important results. First, the amount of sales of PPE compared to the amount of depreciation was much smaller. This shows the use of PPE for internal purposes exceeds that of external purpose uses. The second result was the amount of sales of PPE was extremely small compared to the level of PPE. This research was consistent with the fact that business operations invest in PPE to support the production process. Overall, CEASA believes most businesses use this method of earning revenues, and the income statement approach would best reflect their practices.

The second critique CEASA had of the balance sheet approach was the logical conceptual clarity of the model was unclear. The definition of assets used by the FASB, according to the writers of the article, was circular and actually defines assets as expected earnings. CEASA argue that while FASB has tried to separate assets from income and make assets superior by stating when income is unclear, assets can be valued, but the two are inextricably linked. However, income is clearer, especially with the rise in intangible assets. Income is also easily seen over horizons, and investors can tell if a business is profitable, or "making money." On the other hand, assets are more difficult to conceptualize, specifically ones such as goodwill or customer relations.

The third point made by the authors was the balance sheet approach has caused a decline in the usefulness of looking at future earnings. Investors look at and purchase investments that have predictable, steady future earnings. The balance sheet-based model considers these earnings changes in assets, which makes them highly unpredictable. This change has already begun to occur, according to CEASA, and will continue to if nothing is done. This, in turn, will make earnings a meaningless valuation, undermining the accounting profession. The loss of usefulness will also cause a greater divide between proficient and non-proficient investors. As the goal of FASB is to level the playing field, this consequence is in direct opposition. Lastly, the CEASA's article stated substantial problems existed with the practical application of the currently used approach. With so many estimates and subjectivity used to value assets, the line between the real economy and financial markets can be blurred.

After laying out four critiques of the balance sheet approach, the article gave suggestions on what they believed to be a "better" framework and model for financial reporting. The first feature to be included was a hard distinction between operating and financing activities. One major trait of what CEASA defines as operating activities was operating assets are primarily for supporting the internal activities and little independent value. Financing activities, on the other hand, would revolve around cash and cash-equivalent assets, such as securities or real estate, that are valuable separate from production activities. All financial statements would reflect this divide and force a shift from "bottom line" accounting. The next major part to an alternate approach to financial reporting would be a larger and more aggressive emphasis on the matching and revenue recognition principles. By doing so, the accounting would more likely follow the logical flow of business. Since businesses are run by cost-benefit analysis, thus the income statement approach would be more valuable and accurate.

III. Change in Thinking

In my three years of preparing to be an accountant, I have never imagined that the way we, as an industry, were performing our jobs and providing information to people could be anything but accurate and logical. The profession itself is known for logic and sensibility. The thought never occurred to me that the balance sheet approach did not fully reflect how the businesses we represent are managed and what tasks and items they give most importance to.

The second way this article enlightened me was to prove the decline in forward-looking usefulness of the numerical value of earnings that the use of the balance sheet approach will cause and how detrimental the decline could be. Currently, the price of a stock is measured at the present value of all future cash flows. This is how investors determine whether or not they should purchase a share and invest in companies, providing the much-needed capital to continue operations and spur innovation. Without the value of earnings, what will investors look toward to gauge returns?

Lastly, the authors from CEASA have showed me the dangers of fair value accounting. We learn in our coursework that the fair value tends to provide better information than historical cost because of the real time estimate. However, when we use as much subjectivity and estimates as we do, we lose the reliability. We create bubbles that are sure to burst, as we saw only a year after this article was published in 2008. If assets were viewed as "unexpired costs," than they would more closely follow the matching principle and better reflect the true nature of business. In this case, fair value, or “mark-to-market” accounting would be unnecessary, since historical cost would provide all needed information.

IV. Future Use

If the income statement approach were to be accepted as the new model for financial reporting, many changes would be made to the work I would do as a public accountant. One major change for public accountants in the auditing sector would be a shift in focus from balance sheet accounts, specifically property, plant, and equipment and inventory, to values such as revenues and expenses. While currently auditors test income statement accounts by pulling invoices, the practice is not as common as counting inventory or pulling receipts for large equipment purchases.

I hope to one day see the income statement approach be recognized as the proper and logical way of financial reporting. However, until then, I can use what the article has taught me to provide more accurate reflections of the businesses I represent. One way to do so is by providing more extensive notes with financial statements, explaining the real importance of earnings when compared to assets. By doing so, hopefully, less proficient users will still be able to participate in the investment market.

Another way to use the information learned is to be more hesitant of using fair value accounting. We are constantly taught that make tradeoffs on the information we produce, whether that is between timeliness and accuracy, or reliability and relevance. I hope by choosing to record a building at historical cost over fair value, I can do my part to reduce the effect of the balance sheet-based method.

One other way I would like to use my newfound knowledge in my future career is to incorporate the idea of separating the types of activities used with a more defined line. When producing an income statement, the bottom line should not be the main objective but the process by which we arrived there. By separating financing activities that produce revenue and operating activities that produce revenue, the user again has a more accurate reflection of the company and its processes. As the saying goes, the destination is not what matters, but the journey taken.

CASE 12: EARNINGS ANNOUNCEMENTS

Google Inc.

1 May 2019

I. Introduction

GAAP is a code all publicly traded companies must adhere to when disclosing financial statements and reporting. However, companies are allowed to report non-GAAP financial performance measures to accompany the required GAAP measurements. In this case, I reviewed and analyzed Google Inc.'s GAAP financial measurement, as well as their non-GAAP measurements. Google Inc. is one of the most successful, publicly traded companies, from earnings to reputation. In looking at their financial statements, I was able to learn how such companies may reach their different values. The press release included in their statements also allowed me to see the reconciliation of the numbers.

In the future, I will be able to use the knowledge I have learned and apply the same process to similar companies. The thought process of determining whether eliminations of certain expense was accurate will aid me in future computations of non-GAAP values, such as net income or earnings. While I did not agree with Google Inc.'s elimination of stock-based compensation, I can see the value and understand why they might. Overall, this case allowed me to not only view financial statements, but taught me to look at all provided information, specifically press releases.

II. Non-GAAP Financial Measures in Press Release

In 2013, Google Inc.'s GAAP net income for the fourth quarter was $3.38 billion, while the non-GAAP income was $4.10 billion, as stated in the press release. This difference is explained in the press release by an attached reconciliation chart. To arrive at their non-GAAP net income from GAAP net income, Google eliminated many expenses normally included in the computation of net income. The first eliminations were of a $902 million stock-based compensation expense to employees and the resulting tax effects in the amount of $191 million. The article, Non-GAAP Performance Measures, stated in a study of 40 U.S. companies one of the most frequent items to be eliminated to compute non-GAAP performance measures was stock compensation. However, according to Item 10(e) of Regulation S-K prohibits the elimination of items that have a similar charge in the prior two years or are likely to occur in the coming two years. This is because in doing so, the expense violates the definition of "infrequent" or "non-recurring." In the case of Google Inc. and their stock-based compensation in the fourth quarter of 2013, a similar charge was made in 2012 and plans to be made in 2014.

The next reconciliation amount was for $15 million related to restructuring expenses. Since restructuring of a company is an infrequent and unusual action, the elimination of this expense to arrive at non-GAAP measures is acceptable, as well as the tax effects of the expense for $11 million. The last reconciliation was for an elimination of a net loss from discontinued operations. Again, this type of event tends to be infrequent in occurrence, so not including the loss in the non-GAAP net income is normal.

III. Stock Market Charts

As shown in Google Inc.'s stock charts for the period January 1, 2013 to February 14, 2014, as their earnings performance improved, the price of their stocks rose, reaching a peak in the fourth quarter of 2013. The stock price had jumps, specifically at the end of each quarter, likely related to the release of performance measures.

Compared to other publicly traded companies on the NASDAQ, Google Inc.'s stock price performance was consistently higher than the average performance, or NASDAQ Index, of other companies. In October of 2013, Google Inc.'s performance fell to match the NASDAQ Index, before spiking to greatly eclipse the average performance. Based on the stock charts, the market perceived Google Inc.'s earning news as "good news." This can be seen as a rise in the line showing stock price.

IV. *Wall Street Journal* Article

According to the article, Google Reports Higher Profit, Google Inc.'s fourth quarter revenues of $16.9 billion were higher than the revenues forecasted by analysts, $16.8 billion. The earnings for the fourth quarter, however, were not as impressive, though investors "shrugged off" the reporting. Earnings for non-GAAP measurements were predicted at $12.20 a share but in reality, only reached $12.01 a share. These relations are consistent with the positive stock market reaction following the January 30, 2014 press release. As companies perform increasingly well, stock prices tend to rise.

The article also mentioned other factors that may have contributed to the positive market reaction. One such factor was Google Inc.'s new imaged based advertisements, or "product listing ads." There had been an increase of purchases of these types of ads throughout 2013. App sales for smartphones through Google Play store also played a large part in the company's "other" revenue line. Lastly, the sale of Motorola, which had been acquired in 2012, encouraged analysts and investors that Google Inc. was ridding itself of a possible distraction. While Google Inc. had many positive reports for 2013, one concern discussed in the article was the decrease in cost-per-click compared to the previous year. Overall though, Google Inc.'s financial performance was extremely encouraging for investors and analysts alike.