Analysis of Accounting Practices Worldwide

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

Oxford
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Approved by

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Abstract

Robert Gore Mounger: Analysis of Accounting Practices Worldwide

(Under the direction of Dr. Vicki Dickinson)

The following is made up of case studies that were completed over the course of a year. These cases were given by our thesis advisor, Dr. Dickinson. These case studies highlight critical topics regarding financial accounting practices around the world. Each case focused on different topics in order to create a complete analysis of the different practices that exist. When outside information was necessary, we often referred to textbooks, academic journals, and the accounting codification database. These cases were designed to show an overall broad knowledge of the accounting profession as well as capture the critical details of the day to day practice.

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Financial Analysis for Potential Investment

HOME HEATERS

Glenwood Heating, Inc.

Vs.

Eads Heater, Inc.

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Executive Summary

Eads Heater, Inc. and Glenwood Heating, Inc. are two easily comparable companies located in Colorado. Both companies sell home heating units and appear to be attractive companies for potential investments. After careful analysis of the financial statements of both companies, I have concluded that Eads Heater, Inc. will be a better overall investment. Multiple factors were taken into account before making this determination, some of which include Eads being primed for future growth and having a positive cash flow.

Investment Analysis

Glenwood Heating, Inc. and Eads Heaters, Inc. are two very similar companies with financial statements that do not appear to be drastically different. However, there are multiple important business decisions that distinguish the two companies from one another and make all the difference. When only looking at the numbers at face value, Glenwood reports better financial ratios than almost all of Eads; therefore, many may choose to invest in Glenwood. However, after taking a further look into the business decisions and practices of both companies; the safer and more secure investment is Eads.

Glenwood Heating, Inc. reported a higher net income, which affects many of the financial ratios involving profitability. At first glance, it appears that Glenwood is and will be more profitable with a higher profit margin, return on assets, return on equity, and earnings per share, but these ratios are not always a good measure of a company and are directly related to the net income. The main difference in net income is correlated to the manner in which the company reports their cost of goods sold (discussed further pg. 5). Glenwood's Statement of Cash flows shows very concerning balances such as loss of $16,374 to operating activities and only $426 as the cash balance at the end of the year. This cash flow will not be sufficient for the company to continue operating and making investors money. Glenwood has to rent an important piece of equipment for $16,000 and does not have a guaranteed price for any year past the next. If this price increases, the company could potentially lose even more money and have a negative cash flow for the year.

Chart A-1:

	Glenwood	Eads
Profit margin	23.27%	17.7
Return on assets	0.14	0.1
Return on owners' equity	0.4	0.34
Earnings per share	$28.98	22.04

These financial ratios (Chart A-1) are favoring Glenwood Heating, Inc. because of the way Eads Heaters, Inc. chooses to report its accounting information. The companies use of conservatism may affect the numbers in a negative way now, but the company is valuable. These ratios do not reflect a poorly run or less profitable business. Eads Statement of Cash Flows was significantly better and should continue to be for the next few years to come. They had a loss of $325 in operating activities but still succeeded with a final cash balance of $7,835. A company that does not have cash readily available is in danger of not being able to pay off current liabilities and could lose profit due to insufficient funds when trying to invest or fund business transactions. A positive cash flow allows for more flexibility as well. The first year of operations does not appear to profitable, but the decisions that were made will increase their profit and performance in the future. One of these decisions being to lease a vital piece of equipment rather than rent it. This lease agreement is for the next 8 years and will not fluctuate. The accounting decision to use LIFO to report cost of goods sold caused the net income to be lower due to the increase of prices throughout the year. This accounting decision misconstrues the performance of the company.

Although the use of conservative accounting methods allows Eads to appear less profitable; in the end, Eads will be the better investment because the profitability and security of the company will most likely increase in the future. The company will also have more flexibility with a positive cash flow and be able to use that cash flow to create more profit. Investing is not always a short term transaction. One should invest on the true value of a company and the rest will take care of itself. The accounting decisions made by Eads will attract conservative investors that are looking for an almost certain profit.

Financial Statement Comparison and Analysis

Income Statements

One of the first things many investors look at is net income. Net income is an important number that can deter many less knowledgeable investors when it does not appear to be extremely profitable. Glenwood and Eads both had the same sales revenue of $398,500, but each company chose to report cost of good sold differently. The price of inventory rose throughout the year and; therefore, the use of LIFO to report cost of goods sold was detrimental to the net income. There was a difference in over $20,000 in net income, but solely because of these practices. Eads also chose to use the double-declining balance method for depreciation on their delivery equipment. This caused Eads to have a larger depreciation expense their first year but will pay off in the future, as their depreciation expense will drop much quicker than Glenwood's. The decision to lease their equipment added even more depreciation expense, but this decision will also pay off in long run as they are not subject to an increase in price for the next 8 years. Additionally, Eads conservatively estimated that 5% of receivables will be unable to be collected; while, Glenwood was overly optimistic with a 1% estimate. These certain accounting decisions by Eads appears to make them seem a lesser company this year, but the conservative estimates will add longevity and security to the company.

Chart A-2

Glenwood Income Statement		
Sales Revenue	$398,500	
Cost of Goods Sold	177,000	
Gross Profit		211,500
Operating Expenses		
Bad Debt Expese	994	
Depreciation Expesne	19,000	
Rent Expense	16,000	
Other Operating Expenses	34,200	
Total Operating Expenses		70,194
Income from Operations		151,306
Interest Expense		27,650
Income Before Taxes		123,656
Provision for Income Tax		30,914
Net Income		92,742

Chart A-3

Eads Income Statement		
Sales Revenue	$398,500	
Cost of Goods Sold	188,800	
Gross Profit		209,700
Operating Expenses		
Bad Debt Expese	4,970	
Depreciation Expesne	41,500	
Rent Expense	0	
Other Operating Expenses	34,200	
Total Operating Expenses		80,760
Income from Operations		129,030
Interest Expense		35,010
Income Before Taxes		94,020
Provision for Income Tax		23,505
Net Income		70,515

Statement of Stockholders Equity

Both companies have 3200 outstanding shares and paid $23,000 in dividends this year. Glenwood has a better total stockholders' equity due to reporting a higher net income. As discussed earlier (pg. 5), the discrepancy in net income is due solely to good accounting decisions by Eads.

Chart A-4

Glenwood Heating, Inc.			
Statement of Stockholders' Equity			
	Common Stock	Paid-In Capital	Retained Earnings
Balance: January 1	$0	$0	$0
Issued Shares for Cash	160,000		
Net Income			92,742
Cash Dividends			23,200
Balance: December 31	160,000	0	69,452

Chart A-5

Eads Heater, Inc.			
Statement of Stockholders' Equity			
	Common Stock	Paid-In Capital	Retained Earnings
Balance: January 1	$0	$0	$0
Issued Shares for Cash	160,000		
Net Income			70,515
Cash Dividends			23,200
Balance: December 31	160,000	0	47,315

Balance Sheet

Balance Sheets do not contain much helpful information specific to investors. Eads allowed for more bad debt and a greater amount of depreciation expense, and still managed to have a greater amount of total assets. Primarily due to the decision to lease equipment for 8 years instead of renting it for a single year. The decision to lease the equipment allows Eads to report the equipment as an asset.

Chart A-6: Glenwood Heating, Inc.

Balance Sheet					
Assets			**Liabilities**		
Current Assets			Current Liabilities		
Cash	$426		Accounts Payable	26,440	
Accounts Receivable	99,400		Interest Payable	6,650	
Allowance for Bad Debts	994		Total Current Liabilities		33,090
Inventory	62,800		Long Term Liabilities		
Total Current Assets		161,632	Notes Payable	380,000	
Property, Plant, and Equipment			Lease Payable	0	
Land	70,000		Total Long Term Liabilities		380,000
Building	350,000		**Total Liabilities**		**413,090**
Accumulated Depreciation- Bui	10,000				
Equipment	80,000		Equity		
Accumulated Depreciation-Equ	9,000		Common Stock	160,000	
Leased Equipment	0		Retained Earnings	69,542	
Accumulated Depreciation-Lea:	0		Total Equity		**229,542**
Total Property, Plant, and Equipment		481,000			
Total Assets		**642,632**	**Total Liabilities and Equity**		**642,632**

Chart A-7: Eads Heater, Inc.

Balance Sheet					
Assets			**Liabilities**		
Current Assets			Current Liabilities		
Cash	$7,835		Accounts Payable	26,440	
Accounts Receivable	99,400		Interest Payable	6,650	
Allowance for Bad Debts	4,970		Total Current Liabilities		33,090
Inventory	51,000		Long Term Liabilities		
Total Current Assets		153,265	Notes Payable	380,000	
Property, Plant, and Equipment			Lease Payable	83,360	
Land	70,000		Total Long Term Liabilities		463,360
Building	350,000		**Total Liabilities**		**496,450**
Accumulated Depreciation- Building	10,000				
Equipment	80,000		Equity		
Accumulated Depreciation-Equipment	20,000		Common Stock	160,000	
Leased Equipment	92,000		Retained Earnings	47,315	
Accumulated Depreciation-Leased Equipment	11,500		Total Equity		**207,315**
Total Property, Plant, and Equipment		550,500			
Total Assets		**703,765**	**Total Liabilities and Equity**		**703,765**

Statement of Cash Flows

This financial statement demonstrates some of the major differences between Eads and Glenwood. Glenwood lost a significant amount of money in operating activities, $16, 374. On the other hand, Eads only lost $325. This shows that Eads is operating much more efficiently and at a lower cost than Glenwood. Eads had a final cash balance of $7,835 while Glenwood's was a mere $426. This cash balance allows Eads to be more versatile and the ability to make investments to better the company, while also covering short term liabilities. Glenwood does not currently even have enough cash to rent the equipment necessary for the year to come and will have to take out a loan. With so little cash on hand, Glenwood is unable to invest back in to the company to improve its operations and future profits. Eads has the cash flow to continue operating in the future and to improve its' overall net worth.

Chart A-8: Glenwood Statement of Cash Flows

Statement of Cash Flows		
Cash from Operating Activities		
Net Income	92,742	
Increase Accounts Receiveable	99,400	
Increase Inventory	62,800	
Increase Accounts Payable	26,440	
Increase Interest Payable	6,650	
Depreciation Expense	19,000	
Bad Debt Expense	994	
Net Cash Provided by Operating Activities		**16,374**
Cash from Investing Activities		
Building purchase	350,000	
Equipment purchase	80,000	
Land purchase	70,000	
Net Cash Provided by Investing Activities		**500,000**
Cash from Financing Activities		
Issuance of common stock	160,000	
Increase in notes payable	380,000	
Payment of dividends	23,200	
Net Cash Provided by Financing Activities		**516,800**
Net Increase in Cash		426
Cash balance on January 1		0
Cash balance on December 31		**$426**

Chart A-9: Eads Statement of Cash Flows

Statement of Cash Flows		
Cash from Operating Activities		
Net Income	70,515	
Increase Accounts Receiveable	99,400	
Increase Inventory	51,000	
Increase Accounts Payable	26,440	
Increase Interest Payable	6,650	
Depreciation Expense	41,500	
Bad Debt Expense	4,970	
Net Cash Provided by Operating Activities		**325**
Cash from Investing Activities		
Building purchase	350,000	
Equipment purchase	80,000	
Land purchase	70,000	
Net Cash Provided by Investing Activities		**500,000**
Cash from Financing Activities		
Issuance of common stock	160,000	
Increase in notes payable	380,000	
Payment of dividends	23,200	
Payment on Leased Equipment	8,640	
Net Cash Provided by Financing Activities		**508,160**
Net Increase in Cash		$7,835
Cash balance on January 1		0
Cash balance on December 31		**$7,835**

Income Statement Presentation: ASC

Totz & Doodlez

Presented by:

Robert Mounger

The University of Mississippi

Totz and Doodlez

FASB has recently created an Accounting Standards Codification website in order to simplify and consolidate all the rules associated with accounting. Now when difficult issues or questions arise, companies can turn to the codification to support the manner in which they would like to present their income statement, balance sheet, or other financial statements. Totz, an SEC registrant, has some difficult issues that needed to be researched in order to know the proper entry and placement of the accounts on an income statement.

1. Net Sales

Totz is primarily a sales company but within the company, there is another department, Doodlez, which is primarily service. Totz had net sales of $74.5 million in 2015, while the service department had a service revenue of $3.9 million. The codification rule (225-10-S99-2) demonstrates that the revenues from services and sales should be combined and not separated on the income statement because the service revenue was less than 10% of the total revenue. However, in 2016, the revenues must be separated because neither entity made up less than 10% of total revenue. The service revenue should be placed under the "Other Operating Section", then under "Revenue from Services". This would then show two separate gross profits and a total gross profits for Totz as one entity.

2. Gross Profit

Similar to the treatment of net sales above, the gross profit and the cost of sales will have to be separated in 2016 because neither entity made up less than 10% of total gross profit or total expenses. The income statement would have two separate gross profits, one for sales and one for revenue. These two gross profits would be added together to get a total gross profit before continuing to subtract out the rest of the expenses. The accounts within cost of sales would be placed under the selling expenses section. They would also have to be separated because neither Totz nor Doodlez made up less than 10% of the total expenses. The FASB ASC rule used for the prior entries is (225-10-S99-2).

3. Gain on Sale of Corporate Headquarters

Some companies would attempt to treat the sale of an abandoned building as an extraordinary item. However, according to ASC 225-10-45-4, extraordinary items are to be no longer recognized. According to ASC 360-10-45-4, the sale of the abandoned building should be treated as the sale of a long lived asset and be included in the income from continuing operations. It would be placed under the "Non-operating" section and further under "Other Revenues and Gains" on the income statement. Also, because Totz presents a subtotal for operating income on the income statement, the amount of the gain from the sale of the building will be included in the subtotal.

4. Class Action Settlement

A class action lawsuit is not unusual in nature but it is infrequent; therefore, it should not be treated as an extraordinary item. This is not a primary activity of the company either. According to ASC 225-20-45-16, the gain on the lawsuit should be reported under the "Non-operating" section and further under "Other Revenues and Gains". The affect of this gain should be disclosed on the face of the income statement or in the notes of the financial statements.

Preparing Financial Statements

Rocky Mountain Chocolate Factory, Inc.

Presented by:

Robert Mounger

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Entries and Unadjusted Trail Balance

		Beginning Balance (February 28, 2009)	1. Purchase Inventories	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	Unadjusted Trial Balance
	Cash and Cash Equivalents	1,253,947			17,000,000	-8,200,000	4,100,000	-2,000,000	-6,423,789	125,000	-498,832	-2,403,458	790,224	3,743,092
	Accounts Receivable	4,229,733			5,000,000		-4,100,000						-702,207	4,427,526
	Notes Receivable, current	0											91,059	91,059
	Inventories	4,064,611	7,500,000	6,000,000	-14,000,000								-66,328	3,498,283
	Deffered Income Taxes	369,197											92,052	461,249
Dr	Other	224,378											-4,215	220,163
	Property and Equipment, Net	5,253,598									498,832		132,859	5,885,289
	Notes Receivable, less current portion	124,452											139,198	263,650
	Goodwill, net	1,046,944												1,046,944
	Intangible assets, net	183,135											-73,110	110,025
	Other	91,057											-3,007	88,050
	Accounts Payable	1,074,643	7,500,000			-8,200,000							503,189	877,832
	Accrued Salaries and Wages	423,789		6,000,000					-6,423,789					0
	Other Accrued Expenses	531,941						3,300,000					-2,885,413	946,528
	Dividend Payable	598,986										3,709	-1	602,694
	Deffered Income	142,000								125,000			-46,062	220,938
Cr	Deferred Income Taxes	827,700											66,729	894,429
	Common Stock	179,696											1,112	180,808
	Additional Paid-In Capital	7,311,280											315,322	7,626,602
	Retained Earnings	5,751,017										-2,407,167		3,343,850
	Sales	0			22,000,000								944,017	22,944,017
	Franchise and Royalty Fees	0											5,492,531	5,492,531
	Cost of Sales	0			14,000,000								693,786	14,693,786
	Franchise Costs	0											1,499,477	1,499,477
	Sales & Marketing	0						1,505,431						1,505,431
Dr	General and Administrative	0						2,044,569					-261,622	1,782,947
	Retail Operating	0						1,750,000						1,750,000
	Depreciation and Amortization	0												0
	Interest Income	0											-27,210	-27,210
	Income Tax Expense	0											2,090,468	2,090,468
	A = L + OE + R - E	0	0	0	0	0	0	0	0	0	0	0	0	0

Entries and Post Closing Balance

		Unadjusted Trial Balance	12. Adjust for Inventory	13. Record Deprecation	14. Wage Accrual	15. Consultants Report (no entry)	Pre-Closing Trail Balance	16. Closing Entry	Post-Closing (Ending) Balance	Actual February 28, 2010 F/S Figures
	Cash and Cash Equivalents	3,743,092					3,743,092		3,743,092	3,743,092
	Accounts Receivable	4,427,526					4,427,526		4,427,526	4,427,526
	Notes Receivable, current	91,059					91,059		91,059	91,059
	Inventories	3,498,283	-216,836				3,281,447		3,281,447	3,281,447
	Deffered Income Taxes	461,249					461,249		461,249	461,249
Dr	Other	220,163					220,163		220,163	220,163
	Property and Equipment, Net	5,885,289		-698,580			5,186,709		5,186,709	5,186,709
	Notes Receivable, less current portion	263,650					263,650		263,650	263,650
	Goodwill, net	1,046,944					1,046,944		1,046,944	1,046,944
	Intangible assets, net	110,025					110,025		110,025	110,025
	Other	88,050					88,050		88,050	88,050
	Accounts Payable	877,832					877,832		877,832	877,832
	Accrued Salaries and Wages	0			646,156		646,156		646,156	646,156
	Other Accrued Expenses	946,528					946,528		946,528	946,528
	Dividend Payable	602,694					602,694		602,694	602,694
	Deffered Income	220,938					220,938		220,938	220,938
Cr	Deferred Income Taxes	894,429					894,429		894,429	894,429
	Common Stock	180,808					180,808		180,808	180,808
	Additional Paid-In Capital	7,626,602					7,626,602		7,626,602	7,626,602
	Retained Earnings	3,343,850					3,343,850	3,580,077	6,923,927	6,923,927
	Sales	22,944,017					22,944,017	-22,944,017	0	22,944,017
	Franchise and Royalty Fees	5,492,531					5,492,531	-5,492,531	0	5,492,531
	Cost of Sales	14,693,786	216,836				14,910,622	-14,910,622	0	14,910,622
	Franchise Costs	1,499,477					1,499,477	-1,499,477	0	1,499,477
	Sales & Marketing	1,505,431					1,505,431	-1,505,431	0	1,505,431
Dr	General and Administrative	1,782,947			639,200		2,422,147	-2,422,147	0	2,422,147
	Retail Operating	1,750,000			6,956		1,756,956	-1,756,956	0	1,756,956
	Depreciation and Amortization	0		698,580			698,580	-698,580	0	698,580
	Interest Income	-27,210					-27,210	27,210	0	-27,210
	Income Tax Expense	2,090,468					2,090,468	-2,090,468	0	2,090,468
	A = L + OE + R - E	0					0	0	0	-3,580,077

Income Statement

Rocky Mountain Chocolate Factory, Inc. Income Statement For Year Ended February 28, 2010	
Revenues	
Sales	22,944,017
Franchise and royalty fees	5,492,531
Total Revenues	28,436,548
Costs & Expenses	
Cost of Sales, exclusive of deprecation and amortization expense of $336,009	14,910,622
Franchise Costs	1,499,477
Sales & Marketing	1,505,431
General & Administrative	2,422,147
Retail Operating	1,756,956
Depreciation and Amortization	698,580
Total Costs and Expenses	22,793,213
Income From Operations	5,643,335
Other Revenues and Gains	
Interest Income	27,210
Other Expenses and Losses	
Interest Expense	0
Other Net	27,210
Income Before Income Tax	5,670,545
Income Tax Expense	2,090,468
Net Income	$3,580,077
Basic Earnings Per Share	$0.60
Diluted Average Common Shares Outstanding	$0.58
Weighted Average Common Shares Outstanding	6,012,717
Dilutive Effect of Employees Stock Options	197,521
Weighted Average Common Shares Outstanding, Assuming Dilution	6,210,238

Balance Sheet

Rocky Mountain Chocolate Factory, Inc. Balance Sheet For Year Ended February 28, 2010	
Assets	
Current Assets	
Cash and cash equivalents	3,743,092
Accounts Receivable, less allowance for doubtful accounts of $395,291	4,427,526
Notes Receivable, current	91,059
Inventories, less reserve for slow moving inventory of $263,872	3,281,447
Deferred income taxes	461,249
Other	220,163
Total Current Assets	12,224,536
Property, Plant, and Equipment	5,186,709
Other Assets	
Notes Receivable, less current portion	263,650
Goodwill, net	1,046,944
Intangible assets, net	110,025
Other	88,050
Total Other Assets	1,508,669
Total Assets	$18,919,914
Liabilities and Stockholders' Equity	
Current Liabilities	
Accounts Payable	877,832
Accrued Salaries and Wages	646,156
Other Accrued Expenses	946,528
Dividend Payable	602,694
Deferred Income	220,938
Total Current Liabilities	3,294,148
Deferred Income Taxes	894,429
Commitments and Contigencies	
Stockholders' Equity	
Preferred Stock, $.10 par value; 250,000 authorized; 0 shares issued and outstanding	
Series A Junior Participating Preferred Stock, authorized 50,000 shares	
Undesignated Series, authorized 200,000 shares	
Common Stock, $.03 par value; 100,000 shares authorized; 6,026,938 shares issued and outstanding	180,808
Additional Paid-In Capital	7,626,602
Retained Earnings	6,923,927
Total Stockholders' Equity	14,731,337
Total Liabilities & Stockholders' Equity	$18,919,914

Statement of Cash Flow Transaction Classifications	
Transaction	Classification
1. Purchase Inventories	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 PPE	Investing
10. Dividends Declared and Paid	Financing
12. Adjust for Inventory Count	Operating
13. Record Depreciation	Operating
14. Wage Accrual	Operating
15. Consultants Report	No entry

Financial Statement Analysis

Company: Unknown

Presented by:

Robert Mounger

The University of Mississippi

Required Questions

1. Raw materials are the materials purchased from venders in order to begin manufacturing goods, but have not yet been including in production. A shipping expense could also be associated with raw materials. These include direct materials and indirect materials. Work-in-Process Inventory are the parts of the inventory that have not yet been completed and transferred to finished goods. The costs associated with work-in-process inventory are the cost of direct material, direct labor, and factory overhead.
   Finished Goods Inventory has been completed in production, but has not yet been sold to a customer. The costs associated with finished goods inventory include direct labor, direct material, factory overhead, and carrying costs.

2. The inventory is recorded net of an estimated allowance for obsolete or unmarketable inventory. The estimated allowance for obsolete or unmarketable inventory is based upon current inventory levels, sales trends, and historical expense, as well as managements estimates of market conditions and forecasts of future product demand, all of which are subject to change. The allowance for obsolete inventory account is a contra asset account.

3. Questions
   a. The allowance for obsolete inventory account is a contra asset account so it will appear below the inventory account on a balance sheet, as well as in a note disclosing that the inventory is recorded at net.

b. End of 2011 = $243,870 / End of 2012= $224,254

233,070 (2011 net inventory balance) + 10,800 (2011 balance, end of year) = $243,870 – Gross amount of inventory at the end of 2011

211,734 (2012 net inventories balance) + 11,628 (2012 write-offs, disposals, other) = $233,362 – Gross amount of inventory at the end of 2012

c. We believe the majority of the reserve for obsolete inventory is attributable to finished goods inventory because these are the goods ready for sale that may be unmarketable. Raw materials and work-in-process inventories would not be
impacted.

4. Questions
   a. Debit: Cost of Goods Sold 13,348
      i. Credit: Allowance for Obsolete Inventory 13,348
   b. Allowance for Obsolete Inventory 11,628
      i. Inventory 11,628

5.

Raw Materials		Work-in-Process	
46,976		1,286	
438,561		126,000	
	442,068	442,068	
			568,735
43,469		619	

Finished Goods		Cost of Sales		Accounts Payable	
184,808		13,348			438,561
	13,348	572,549			39,012
568,735				432,197	
	572,549				
167,646		585,897			45,376

6. 2011 Inventory Turnover Ratio = 2.29

$$\frac{575{,}226 \text{ (2011 cost of sales)}}{250{,}830.50 \text{ (2011 average inventories balance)}}$$

2012 Inventory Turnover Ratio = 2.63

$$\frac{585{,}897 \text{ (2012 cost of sales)}}{224{,}402 \text{ (2012 average inventories balance)}}$$

7. 2011 Inventory Holding Period = 159.39

   2012 Inventory Holding Period = 138.78

$$\frac{365}{\text{Year Inventory Turnover Ratio}}$$

On average, during 2011 the company was taking approximately 159 days to manufacture and sell their inventory. However, in 2012, the company was taking approximately 139 days to manufacture and sell their inventory. Therefore, the company has decreased the length of their holding period by 20 days from 2011 to 2012. This shows that the company is becoming more efficient in its inventory management.

8. Upon analyzing this company, one must ask why 7.37% of finished goods is being considered obsolete and what the company is doing to decrease that number. I would like to know who is determining the optimal frequency for producing or ordering products and how this is calculated.

Percentage of Obsolete Finished Goods = 7.37%

$$\frac{\text{12,348 (2012 inventory reserve provision)}}{\text{167,646 (2012 ending FG inventory) + 13,348}}$$

Improper Capitalization Methods

Company: WorldCom, Inc.

Presented by:

Robert Mounger

The University of Mississippi

WorldCom, Inc.

Concepts

a. FASB Statement of Concepts No. 6

i. According to FASB Statement of Concepts No. 6, assets can be considered the present value of future cash flows. Assets are the likely benefit in the future from actions taken in the past. Expenses are seen as the necessary use of assets in order to continue the central operations of a firm.

ii. Costs should be capitalized when they increase the useful life of the asset, increase quantity of service produced form the asset, or the quality of units produced from the asset must be enhanced. All of these are costs that are incurred in order to achieve greater future benefits from the asset. Costs should be expensed if they simply maintain a given level of service and have no future earning benefits.

b. After costs are capitalized they initially become part of a depreciable asset. Instead of these expenses having a large impact on the income statement in one single year, the expenses will eventually be depreciated over the life of the asset. Depreciating an asset is a much slower way of expensing out the costs associated with the asset and will have a lesser effect on the income statement of a single year. However, these expenses will effect the income statements over a longer period of time on a much smaller scale.

Process

c. WorldCom, Inc. reported "Line costs" for the year ended December 31, 2001 as $14,739,000,000. The line costs incurred by WorldCom were associated with paying local telephone providers to complete calls for WorldCom Inc. customers. This connected calls WorldCom, Inc. users with users throughout the country.

Journal Entry:

12/31/2001	Line Costs (Exp)	14,739,000,000	
	Cash		14,739,000,000

d. WorldCom, Inc. was improperly capitalizing their line costs adding them back into their Property, Plant, and Equipment Assets. These line costs were things such as the cost associated with paying local telephone providers to complete calls for WorldCom Inc. customers. These costs are not associated with any asset that could be a part of their PPE. They were paying other companies for services. These costs do not qualify as those which should be expensed. WorldCom, Inc. fraudulently capitalized these costs in order to manipulate net income.

e. These costs would have appeared under the investing activities section in the statement of cash flow as a capital expenditure. The line costs would appear on the balance sheet as part of the assets under property, plant, and equipment because the expenses were improperly capitalized into these accounts.

Analysis

f. WorldCom, Inc. Depreciation Expenses (in millions) for 2001

Based on Midpoint Useful Life of 22 Years

Quarter 1: ($771/22) x (4/4) = $35,045,454.55

Quarter 2: ($610/22) x (3/4) = $20,795,454.55

Quarter 3: ($743/22) x (2/4) = $16,886,363.64

Quarter 4: ($931/22) x (1/4) = $10,579,545.55

Total Depreciation Expense for 2001 = $83,306,818.19

Journal Entry:

12/31/2001	Depreciation Expense	83,306,818	
	Accumulated Depreciation		83,306,818

g. The difference in net income is material. The net income for WorldCom, Inc. was approximately $1,501,000,000 in 2001 to a net loss of $341,150,568.

Income before taxes, as reported	$2,393,000,000
Add: Depreciation for year	83,306,818
Deduct: Line costs improperly capitalized	(3,055,000,000)
Loss before taxes, as reported	(578,693,182)
Income tax benefit (35%)	202,542,614
Minority interest	35,000,000
Net loss, restated	$341,150,568

Accounting Standards Codification

Targa Co.

Presented by:

Robert Mounger

The University of Mississippi

<u>Targa Co.</u>

FASB has recently created an Accounting Standards Codification website in order to simplify and consolidate all the rules associated with accounting. Now when difficult issues or questions arise, companies can turn to the codification to support the manner in which they would like to present their income statement, balance sheet, or other financial statements. Targa Co., as an SEC registrant, has some difficult issues that needed to be researched in order to know the proper entry and placement of the accounts within the financial statements. It is essential that the company's issues are taken care of in accordance with U.S. GAAP.

<u>Employee Benefits</u>

Targa Co. has decided to restructure a business line, and in doing so will have terminate the contracts of 120 to 125 employees. Due to this being a nonvoluntary termination, the company has decided to offer a one-termination benefit that is contingent on employee's continued service through the date Targa ceases production and closes the facility. The management has committed to a plan of termination, identified the number of employees that will be terminated, and established a clear plan for the benefit arrangements in detail, all of which is in accordance with ASC 420-10-25-4. In addition, according to ASC 420-10-30-6, if the employees are required to keep working until they are terminated to receive the termination benefits then a liability for the benefits shall be measured initially at the communication date based on the fair value of the liability as of the termination date. Therefore, the $2,500,000 one-time termination benefit should be recognized as liability and a loss when the employees accept the offers because the amount can be reasonably estimated. This is also in compliance with ASC 712-10-25-1.

Historically, Targa has provided two weeks' severance to individual employees upon nonvoluntary termination. Therefore, in accordance with ASC 7-12-25-2, Targa should account for the additional $500,000 and the additional $50,000 in contractual termination benefits as a liability and a loss when it is probable that the employees will be entitled to the benefits since the amount is reasonably estimable. The cost of termination benefits recognized as a liability and a loss should include the amount of any lump-sum payments and the present value of any expected future payments.

Relocation and Retraining Costs

Targa Co. has decided to restructure the business and in doing so, relocate the manufacturing operation from its present location to a new facility in a different geographic area. According to ASC 420-10-15-4, the restructuring of the business should be handled as an "exit activity". The relocation cost of $500,000 as well as the staff retraining costs of $1,500,000 should not be recorded as liability even when the company commits to the exit or relocation plan, according to ASC 420-10-25-2 and ASC 420-10-30. Only present obligations to others are liabilities and in order to be considered a present obligation when a transaction or event occurs that leaves little or no discretion to avoid the future transfer or use of assets to settle liability. In conclusion, an entity's commitment to an exit or disposal plan, by itself, does not require the costs to relocate or retrain to be recognized as a liability.

Shareholders' Equity

Merck & Co.

Presented by:

Robert Mounger

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Concept Questions

A. Consider Merck's common shares.

1. How many common shares is Merck authorized to issue?
    a. **Merck is authorized to issue 5,400,000,000 common shares.**

2. How many common shares has Merck actually issued at December 31, 2007?
    a. **Merck has actually issued 2,983,508,675 common shares.**

3. Reconcile the number of shares issued at December 31, 2007, to the dollar value of common stock reported on the balance sheet.
    a. The common stock is worth $29,835,087 according to the number of shares issued and the par value.

4. How many common shares are held in treasury at December 31, 2007?
    a. **There are 811,005,791 common shares held in treasury.**

5. How many common shares are outstanding at December 31, 2007?
    a. There are 2,172,502,884 common shares outstanding.

6. At December 31, 2007, Merck's stock price closed at $57.61 per share. Calculate the total market capitalization of Merck on that day.
    a. 125,157,891,100 is the total market capitalization on 12/31/2007.

C. Why do companies pay dividends on their common or ordinary shares? What normally happens to a company's share price when dividends are paid?

It makes the company more appealing to invest in, knowing they will be receiving part of their investment back on a regular schedule. It can also be a negative in the case that the company has run out of growth opportunities. More times than not, the company has the ability to pay a dividend due to sufficient Retained Earnings and chooses to do so in order to give back to its stockholders.

Share prices usually go down when dividends are paid because they are having to use company assets to pay the dividends to stockholders. The market quickly adjusts and the stock price returns back to normal. Normally, the stock price is boosted the few days leading up to the ex dividend date because investors know they will receive a stock dividend if they buy shares. This boost in investments can balance out the effect on assets of the dividend distribution.

D. In general, why do companies repurchase their own shares?

If the stock is undervalued, companies try to buy back stock at a low price and resell at a high price. Repurchasing their own shares also decreases the amount of shares outstanding and therefore, increases Earnings Per Share and Return on Equity. This stock could also provide stock that could be used for employee compensation plans.

E. Consider Merck's statement of cash flow and statement of retained earnings. Prepare a single journal entry that summarizes Merck's common dividend activity for 2007.

Dr: Retained Earnings	**3,310.7 million**	
Cr: Dividends Payable		**3.4 million**
Cr: Cash		**3,307.3 million**

G. During 2007, Merck repurchased a number of its own common shares on the open market.

1. Describe the method Merck uses to account for its treasury stock transactions.
    a. **Merck is using the cost method in order to account for its treasury stock transactions. This is method is the predominately used method in which treasury stock is debited at cost. The treasury stock is deducted from the bottom of the Stockholders Equity section after totaling contributed capital and retained earnings.**

2. Refer to note 11 to Merck's financial statements. How many shares did Merck repurchase on the open market during 2007?
    a. **Merck repurchased 26,500,000 shares off the open market during 2007.**

3. How much did Merck pay, in total and per share, on average, to buy back its stock during 2007? What type of cash flows does this represent?

a. **Merck paid a total of 1,429.7 million dollars to buy back its own stock and it would be $53.95 per share. This would be an example of a financing activity on the Statement of Cash Flows.**

4. Why doesn't Merck disclose its treasury stock as an asset?
    a. **It doesn't provide any actual income because we cannot gain income from dealing in our stock. This is an economic benefit because we can receive a cash benefit by reselling our own stock at a higher price.**

Analysis

I. Determine the missing amounts and calculate the ratios in the table below for Merck only. What differences do you observe in Merck's dividend ratios across the two years?

Merck and Co.		
Year	2007	2006
Dividends Paid	3,307.30	3,222.60
Shares outstanding	2,172,502,884	2,167,785,445
Net Income	3,275.40	4,433.80
Total Assets	48,350.70	44,569.80
Operating Cash Flows	6,999.20	6,765.20
Year-end stock price	57.61	41.94
Dividends per Share	1.52	1.53
Dividend Yield	2.64%	3.65%
Dividends Payout	1.01	0.75
Dividends to Total Assets	0.07	0.07
Dividends to Opeerating Cash Flows	0.47	0.49

It appears as though Merck and Co. had a more profitable year in 2006 and were able to better utilize their assets. Although the stock price may be higher, in terms of dividend yield, the value per share of stock was higher in 2006.

Stock Compensation Plans

Xilinx, Inc.

Presented by:

Robert Mounger

The University of Mississippi

<u>Concepts</u>

A. One of Xilinx's equity incentive plans is its employee stock option plan discussed in Notes 2 and 6. Explain, in your own words, how this plan works. What incentives do stock option plans such as this one provide to employees?

   i. **Stock options plans provides an incentive for the employees, managers, or executives of a company to increase stockholders' equity and increase the value per share of common stock. This is because the stock options will only be valuable at the time of vesting if the stock price of the company has increased. If the company wants it stock price to increase, it must increase the overall value of the company.**

B. Xilinx also discusses the use of restricted stock units, also called RSUs (on page 63 of Xilinx's annual report). RSUs are grants valued in terms of Xilinx stock, but Xilinx does not issue the stock at the time of the grant. Upon satisfying the vesting requirements, Xilinx distributes to employees either shares or the cash equivalent of the number of shares used to value the unit. Compare the use of RSUs and stock options as a form of incentive compensation to employees. Why might companies offer both types of programs to employees?

   i. **Under restricted stock plans, companies issue shares of restricted stock to employees. These restricted shares can not be sold until vesting occurs. If an employee leaves the company prior to vesting, they forfeit these shares and they return to the company, including**

any dividends received as well. There are few advantages of restricted stock in comparison to stock options. Restricted stock never becomes worthless, results in less dilution to existing stockholders, and better aligns employee incentives with the company's incentives by providing more of long-term prospective. Stock options can offer a long-term incentive but also a huge short-term incentive when the option is near to its expiration. If at the time of expiration, the common stock price of stock is less than the strike price offered in the stock option; the option is worthless. Both restricted stock and stock options are good incentives. However, depending on how the company would like to incentivize and pay their employees, the compensation plan may change.

C. Explain briefly the following terms used in Notes 2 and 6: grant date, exercise price, vesting period, expiration date, options/RSUs granted, options exercised, and options/RSUs forfeited or cancelled.

i. **The grant date is the day the options are received. The exercise is the price at which you will be allowed to purchase the shares regardless of the current market price. The vesting period is the time in between the grant date and the vesting date. The expiration date is the last day possible to exercise the stock options or they will expire and become worthless. If a stock option or RSU is granted, this means that it has now been given to an employee and that employee can or will be able**

to exercise the options or RSU's at some point in the future. If an option is exercised, then the holder of the options bought stock at the strike price and more than likely immediately sold the stock for a gain. An option is forfeited usually because the employee fails to satisfy a service requirement. In this case the company should adjust the estimate of compensation expense recorded in the current period. If RSU's are canceled, then the company must reverse compensation expense recorded to date because vesting never occurred.

D. Consider the information on the employee stock purchase plan (page 63 of Xilinx's annual report). Explain, in your own words, how this plan works. What incentives does this plan provide for Xilinx employees? How do these incentives differ from the incentives created under the employee stock option and RSU plans?

i. **The employee stock purchase plan allows employees to use a small part of their salary to purchase their own company's stock at a discount. The employee pays 85% of the fair market value of the stock instead of paying full price, therefore, can immediately recognize a gain of 15% on the common stock purchased. The employees have the option to purchase the stock using this plan at the end of every six-month period, but do not have to purchase anything.**

I believe this provides an incentive for the employees to stay at the company and continue doing good work. They can receive a "bonus"

through the plan every 6 months on the job. It will also motivate them to increase the price of the stock because are more than likely personally invested in the stock as well.

The employee stock purchase plan differs from the stock option plans and the RSU's because it doesn't solely incentivize the employees to increase the stock price for personally gain. RSU's and stock options are just given to the employees over a certain period of time and the higher the stock price the more valuable they both are. This can cause top managers and other employees do to things that are not ethical in order to increase the stock price and make more money. While, an employee stock purchase plan is still valuable whether the stock price increases or decreases because the employee pays only 85% of the fair market value.

E. Note 2 describes Xilinx's accounting for stock-based compensation. Describe how Xilinx accounts for employee stock option activity? For RSU activity? For activity under the stock purchase plan?

   i. **The Company is required to measure the cost of all employee equity awards that are expected to be exercised based on the grant-date fair value of those awards and to record that cost as compensation expense over the period during which the employee is required to work throughout the vesting period of the reward. In addition, the Company is required to record compensation expense for the**

unvested portion of previously granted awards that remain outstanding at the date of adoption. Any excess tax benefits should be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. The exercise price of employee stock options is equal to the market price of Xilinx common stock on the date of grant. Additionally, Xilinx's employee stock purchase plan is deemed a compensatory plan. Accordingly, the employee stock purchase plan is included in the computation of stock-based compensation expense.

The Company uses the straight-line attribution method to recognize stock-based compensation costs over the requisite service period of the award. Upon exercise, cancellation or expiration of stock options, deferred tax assets for options with multiple vesting dates are eliminated for each vesting period on a FIFO system. To calculate the excess tax benefits available for use in offsetting future tax shortfalls as of the date of implementation, the Company followed the alternative transition method.

<u>Process</u>

F. Consider Xilinx's 2013 statement of income, statement of cash flows and the table on page 59 of Xilinx's annual report that discloses information about stock-based compensation expense.

i. According to the table on page 59, what total expense (before income taxes) does Xilinx report for stock-based compensation in 2013?

   i. **The total expense reported by Xilinx for stock-based compensation expense is $77,862.**

ii. Where on the statement of income does Xilinx include this expense? Explain.

   i. **This expense is included in operating expenses. However, the expense was broken down into three categories which included: Cost of Goods Sold, Research and Development Expense, and Selling, General, and Administrative Expense.**

iii. How does the 2013 expense affect the statement of cash flows? Describe where the amount of the expense appears in the statement of cash flows.

   i. **It is seen as line item on the statement of cash flows under the operating section. It increases the amount of cash provided by Operating Activities.**

iv. Explain in general terms, the income tax effects of Xilinx's 2013 stock-based compensation expense.

i. **Due to the fact compensation is a pretax expense, it decreases the amount of taxable income by the client. This is acceptable accounting, but this is not acceptable according to tax law. Therefore, until the stock-options are exercised, the income tax effects will be treated as a "Deferred Tax Asset".**

v. Prepare the journal entry to record Xilinx's 2013 stock-based

Entry:		
COGS	6,356	
R&D Expense	37,937	
SG&A Expense	33,569	
	PIC- Stock Options	77,862
Deferred Tax Asset	22,137	
	Income Taxes Payable	22,137

compensation expense. Your journal entry should include tax effects.

<u>Analysis</u>

G. Refer to the *Wall Street Journal* article titled “Last Gasp for Stock Options.”

i. What trends does the article discuss in the use of employee stock options and restricted stock awards? Based on the article, which plan do companies find more attractive in recent years? Discuss the reasons for this view. Which plan do you think employees prefer? Why?

i. **It appears as though the use of stock options is declining and the use of restricted stock is increasing.**

Companies have begun to find restricted stock more attractive for many reasons. First, stock options can become worthless in volatile market that has nothing to do with the performance of the employees. Top executives and employees need to be guaranteed at least part of their compensation every year. Also, when it comes to taxes, accounting for restricted stock is much simpler and more uniform from place to place. Lastly, stock options can also cause a drop in moral when the options end up worthless. There are so many factors that play into the market price of the stock, that is impossible to predict the future value of the options.

I believe that employees are beginning to realize that restricted stock is a much better and safer form of compensation in

comparison to stock options. Restricted stock does not become worthless and is guaranteed. Sure, the potential to make large sums of money with stock options is appealing, but the risk is huge compared to restricted stock. At the end of day, most employees will prefer a guaranteed compensation over a potentially worthless compensation plan.

ii. Referring to the tables in Xilinx's footnotes that detail stock option grant and RSU grant activity in recent years (pages 62 and 63 of Xilinx's annual report), is the trend in grants of these two forms of stock-based compensation consistent with the trends noted in the article? Cite the information used to support your answer.

i. **When examining the footnotes of Xilinx, Inc. the trends stated in the article followed suit. According to Emily Chasan at the Wall Street Journal, "Stock options are on the verge of extinction.**

The once-popular form of pay, which for decades enriched senior executives and sometimes turned secretaries into millionaires, is almost disappearing as companies gravitate toward restricted stock awards." Xilinx has been decreasing the amount of stock options issued significantly, going from 2,345 granted in 2010, to only 207 granted in 2011. They have also been increasing the amount of restricted stock issued,

increasing from 2,043 RSU's granted in 2010, to 2,977 RSU's granted in 2011.

Five-Step Revenue Model

Beir Haus

Presented by:

Robert Mounger

The University of Mississippi

Part I:

Background:

Week 1: a college student walks into the Bier Haus on campus and orders a large plastic cup of beer. The bartender takes the order and says it will cost $5. The student hands the bartender $5. The bartender then pours the beer into a large cup and hands it to the student. The student rushes off to ACCY 304.

Requirements:

1. Read ASC 606-10-05-04, 606-10-25-1 and 606-10-25-30.
2. How does each step in the five-step revenue model apply to this transaction?

Step 1: The contract was identified when the student verbally ordered the beer from the bartender and then agreed to pay the $5 that the bartender asked for. The payment terms were agreed upon. The rights regarding the good (beer) were agreed on as well; as ownership of the beer transferred to the student and the $5 to the bar. The future cash flows of the company were impacted by the amount of $5 and the bar collected all of the payment immediately in exchange for the good.

Step 2: The performance obligations in the contract were met as the bartender fulfilled his promise and transferred the beer to the student. The student also met his/her obligation by paying $5 for the good.

Step 3: The transaction price was $5 for the good received. The bar received this payment immediately.

Step 4: The transaction price of $5 was based on the performance obligation of the bartender giving the student a beer in a large plastic cup.

Step 5: Revenue should be recognized immediately, because the performance obligation was performed simultaneous as the payment was made. After handing the student the beer, the revenue can be recognized.

3. Prepare the journal entry for the transaction.

   – Debit: Cost of Goods Sold

     Credit: Inventory- Beer

     Credit: Inventory-Plastic Cups

   – Debit: Cash

     Credit: Sales Revenue

Part II:

Background:

Week 2: the same student goes into the Bier Haus and orders a large beer in an Ole Miss thermal beer mug as part of a "drink on campus" campaign. The student plans to use this mug daily for refills rather than using plastic cups. The bartender pours the beer into the mug and delivers it to the student. The bartender then collects $7 from the student. Standalone selling prices are $5 for the beer and $3 for the mug, so the student got a bargain on the combined purchase. The student takes the beer in the new mug and enjoys it while reading the codification.

Requirements:

1. Read ASC 606-10-25-19 to 22 and 606-10-32-31 to 32.
2. How does each step in the five-step revenue model apply to this transaction?

Step 1: The contract was made was soon as when the student verbally ordered the beer and mug from the bartender and then agreed to pay the $7 that the bartender asked for. The payment terms were agreed upon by both parties. Ownership of the goods was transferred between the two parties.

Step 2: The goods in the transaction are highly interdependent and therefore considered one performance obligation. This means they are accounted for together. The service promised can only be performed if the goods are actually transferred to the customer.

Step 3: The transaction price was $7 for the goods received. The bar received this payment immediately.

Step 4: Now the standalone prices must be applied to each of the goods transferred in order to calculate the price of the performance obligations. The original standalone selling prices were $5 for the beer and $3 for the mug. However, there was a discount of $1 when the goods were transferred together. The beer was discounted around 62 cents, while the mug was discounted around 38 cents from their original standalone prices.

Step 5: Revenue should be recognized immediately, because the performance obligation was performed simultaneous as the payment was made. After handing the student the beer and mug, the revenue can be recognized.

3. Prepare the journal entry to record the transaction.

   - Debit: Costs of Goods Sold

     Credit: Inventory- Beer

     Credit: Inventory- Mugs

     Debit: Cash

     Debit: Discount

     Credit: Sales Revenue

Part III:

Background:

Week 3: the same student goes into the Bier Haus bringing in his beer mug and orders a large beer and a pretzel. Standalone selling prices are $5 for the beer and $2 for the pretzel. The bartender tells the student they are out of pretzels. The bartender then offers the student the large beer and a coupon for two pretzels (its typical business practice) for $7. The student pays the $7 to the bartender. The bartender gives the student a coupon for two pretzels. The bartender pours the beer into the beer mug and hands it to the student. The student then takes the beer and the coupon and heads to the dorm to study for the upcoming Intermediate accounting exam. The Bier Haus sells a coupon for two pretzels for $3.50. To increase visits, these coupons can be redeemed any date after the date of purchase. The Bier Haus has limited experience with these coupons but, so far, these coupons have always been redeemed.

Requirements:

1. Read ASC 606-10-25-2 to 6.
2. How does each step in the five-step revenue model apply to this transaction?

Step 1: There are multiple contracts to be identified within the following transaction. Both parties orally agreed to different contracts. First, the bartender agreed to accept $5 dollars for the price a beer and the student agreed to pay the amount. Second, the bartender agreed to give the student a coupon for two pretzels at the price of $2 dollars that will allow the student to purchase two pretzels in the future. The second contract has no fixed duration and the likelihood of collectible is very probable.

Step 2: There are two performance obligations within the oral contract. First, the bartender agreed to accept $5 for a beer and give the beer to the student. This performance obligation has been fulfilled. Second, the bartender received $2 for a coupon and agreed to let the student use the coupon to receive two pretzels at a future date. This performance obligation should be fulfilled at anytime in the future.

Step 3: The transaction price was $7 for the goods received. The bar received this payment immediately.

Step 4: Now the standalone prices must be applied to each of the goods transferred in order to calculate the price of the performance obligations. The original standalone selling prices were $5 for the beer and $2 for the coupon. However, there was a discount of $1.50 on the coupon in comparison to its normal price of $3.50.

Step 5: Revenue should be recognized immediately, because the performance obligation was performed simultaneous as the payment was made. After handing the student the beer and coupon, the revenue can be recognized.

3. Prepare the journal entry to record the transaction.

- Debit: Cost of Goods Sold

  Credit: Inventory- Beer

  Credit- Inventory- Pretzels

  Debit: Cash

  Credit: Sales Revenue

  To record sale of beer

Debit: Cash

Debit: Discount

Credit: Coupon

To record the sale of the pretzel coupon

Part IV:

Background:

Week 4: the same student goes into the Bier Haus and orders two pretzels. The bartender takes the order and asks for a $4 payment. The student hands the bartender the coupon. The bartender reviews the coupon, determines its validity, and accepts it as payment. The bartender gives the student the two pretzels. The student then heads off to share the pretzels with a classmate from ACCY 420.

Requirements:

1. How does each step in the five-step revenue model apply to this transaction?

Step 1: The contract was made verbally as the student ordered the two pretzels from the bartender. The price was also agreed upon and accepted by both parties.

Step 2: The performance obligations in the contract were met as the bartender fulfilled his promise and transferred the pretzels to the student. The student also met his/her obligation by paying giving the valid coupon to the bartender.

Step 3: The transaction price was determined to be $4 dollars for the two pretzels. The student will be giving the coupon as substitution for the payment of $4.

Step 4: The transaction price of $4 was based on the performance obligation of the bartender giving the student a two pretzels. The obligations from both parties were met.

Step 5: The bartender validates the coupon and accepts the coupon as payment. Once the he accepts the coupon and all performance obligations are met. The revenue is recognized.

2. Prepare the journal entry to record the transaction.

   – Debit: Costs of Goods Sold

     Credit: Inventory- Pretzels

     Debit: Coupon

     Credit: Sales Revenue

Deferred Income Taxes

ZAGG Inc.

Presented by:

Robert Mounger

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ZAGG INC.

Concepts

a. Book income is the same thing as income before taxes. “It is a company’s pretax financial income according to GAAP. They measure it with the objective of providing useful information to investors and creditors”, according to the authors of the Intermediate Accounting textbook.

It is $23,898 which is labeled as “Income before provision for income taxes”.

For financial reporting, companies use the full accrual method to report revenues. For tax purposes, they use a modified cash basis. Taxable income is determined according to the Internal Revenue Code.

b. Define:

   i. Permanent Tax Differences result from items that enter into pretax financial income but never into taxable income, or enter into taxable income but never into pretax financial income. Permanent differences do not reverse over time either. Example: A company pays life insurance premiums for its key officers of $5,000 in 2016 and 2017. Although not tax-deductible, Bio-Tech expenses the premiums for book purposes.

   ii. A temporary Tax difference is the difference between the tax basis of an asset or liability and its reported amount in the financial statements, which will result in taxable amounts or deductible amounts in future years. Taxable amounts increase taxable income in future years. Deductible amounts decrease taxable income in future years.

Example: A company reports gross profit of $18,000 from an installment sale in 2015 for tax purposes over an 18-month period at a constant amount per month beginning January 1, 2016. It recognizes the entire amount for book purposes in 2015.

iii. A Statutory Tax rate is a tax rate that is imposed by law. For example, a sales tax may have a flat statutory rate.

iv. The Effective tax rate is the percentage of taxes that a company actually pays. The effective tax rate is also called the average tax rate, in some cases.

c. A company generally reports deferred income taxes as part of their total income tax expense because of the differences in the standards of reporting. Often companies will recognize revenue and expenses when they can reasonably expect said revenue and expenses will occur, for tax purposes, these revenues and expenses will not be recognized until cash has been paid.

d. A deferred tax asset is the deferred tax consequence attributable to deductible temporary differences. Basically, a deferred tax asset represents the increase in taxes refundable in future years as a result of deductible temporary differences existing at the end of the current year.

Example: A company accrues a loss and related liability because of pending litigation. The company cannot deduct this pending loss for tax purposes until it pays the liability, expected the next year. As a result, a deductible amount will occur during the in the next year when Hunt settles the liability, causing taxable income to be lower than pretax financial information.

A deferred tax liability is the deferred tax consequences attributable to taxable temporary differences. Basically, a deferred tax liability represents the increase in taxes payable in future years as a result of taxable temporary differences existing at the end of the current year.

Example: Temporary differences in reporting often create deferred tax liabilities. For example, a temporary difference exists because at year-end a company reports the revenue and related accounts receivable differently for book and tax purposes. If the book basis for accounts receivable is higher than the tax basis, then a deferred tax liability is created.

e. A deferred income tax valuation allowance is an account that a company will establish when it becomes very probable that the company will not realize a portion of the deferred tax asset due to a loss in net income. By setting up this account, the company will not completely lose the value of the deferred tax asset and will be able to use to their advantage later once the company is not operating at a loss.

Process

f. Note 8- Income Taxes

   i. Income tax provision in 2012

Income Tax Expense	9,393	
Net Deferred Tax Asset	8,293	
Income Taxes Payable		17,686

ii. The separation of the "net deferred income taxes"

Income Tax Expense	9,393	
DTA	8,002	
DTL	291	
Income Tax Expense		17,686

iii. Zagg's 2012 Effective Tax Rate

Effective Tax Rate = 9,393 / 23,898 = **39.3%**

The difference in between the statutory rate and the effective rate is due to all the permanent tax differences. The statutory rate is just a baseline that hardly any company will actual pay in full due to various deductions and credits. Various deferred tax benefits will decrease the current amount of taxes being paid.

iv. This number is represented in current assets for the current portion of 6,912 and in the noncurrent assets for the noncurrent portion of 6,596. Like most cases in financial reporting, everything should be faithfully represented. By reporting the current assets in this manner, investors and creditors can better understand what the future tax effect of these assets will have on Zagg Inc.

All of the above work has been written using interpretations from the Intermediate Accounting textbook written by Donald Kieso, Jerry Weygandt, and Terry Warfield.

Leases

Build-A-Bear Workshop, Inc.

Presented by:

Robert Mounger

The University of Mississippi

Concepts

A. Companies often times lease assets as opposed to buying them for multiple reasons. One, the company does not need all the capital to purchase the asset from the start and is able to pay smaller amounts on a regular occurring basis, which helps with the company's cash flow. The free cash can then be invested if opportunities arise. The company will also receive immediate access to the asset just as if buying it, and it will always be the newest equipment. Lastly, there are also tax benefits due to the fact the lease expenses are deductible from a company's taxable income.

B. Types of leases

   a. An Operating Lease is a lease whose term is short compared to the useful life of the asset being leased. A company does not recognize any asset from an operating lease on its balance sheet.

   b. A Capital Lease is a lease in which all of the rights of ownership transfer to the lessee receiving the asset. A capital lease is held for close to the full amount of economic life of the asset.

c. A Direct Financing Lease is a lease where the lessor will recognize a receivable and take the asset of their books. It is like a combination of a sale and financing transaction.

d. A Sales-Type Lease is a lease where the asset is valued at the fair value of the lease by the lessor, involves real estate, and there is a transfer of ownership.

C. There are different types of leases because they have different financial implications and each offers different advantages and disadvantages.

Process

D. Hypothetical Situation

a. This will be treated as an operating lease because Build-A-Bear Workshop is only renting the location for a short period of time, less than 75% of the economic life of the location, and the title or ownership of the land does not transfer to the lessee at the end of the term.

b. Rent Expense 100,000

Rent Expense	100,000	
Cash		100,000

c. Rent Expense 100,000

Rent Expense	100,000	
Deferred Rent Expense		100,000

Interest Expense	100,000	
Deferred Rent Expense	25,000	
Cash		125,000

E. Examining Note 10

a. Rent expense on the operating leases for the offices and retail stores was $45.9 million in 2009 and there was a contingent rent of $0.9 million.

b. Rent expense appeared as a part of Selling, General, and Administrative Expenses on the Income Statement.

Analysis

F. Capital Leases

N=8		Discount Rate = 7%	
Year	Lease Payment	Discount Factor	PV of Payments
1.00	50651.00	0.93	47338.42
2.00	47107.00	0.87	41143.25
3.00	42345.00	0.82	34566.22
4.00	35469.00	0.76	27059.30
5.00	31319.00	0.71	22330.45
6.00	25228.67	0.67	16809.86
7.00	25228.67	0.62	15709.89
8.00	25228.67	0.58	14683.09
			219640.48

a.

b. Leased PPE 219,643

Lease Obligation 219,643

c. Omit

d. Omit

e. Lease Obligation 35,276

Interest Expense 15,375

Cash 50,651

Depreciation Expense 27,455

Accumulated Depreciation 27,455

f. Omit

G. By structuring the lease as an operating lease, the company will save because the leasing expenses are deductible from pre-tax income. They would also avoid having any accumulated deprecation on the balance sheet.

H. If Build-A-Bear had capitalized their operating leases

Potential Impacts on Ratios

	Operating Lease	Capital Lease
Current Ratio	1.6578	1.6798
Debt-to-Equity	0.7252	1.844
Long-Term Debt-to-Assets	0.1323	0.4659

After calculating the above ratios, it appears as though capitalizing leases will yield weaker liquidity and solvency ratios. However, I do not believe this is always the case. For example, a ratio such as Debt-to-Equity depends highly on Net Income and other factors that wouldn't be directly affected by the capitalization of a lease.

References

"FASB Accounting Standards Codification." FASB Accounting Standards Codification., asc.fasb.org/.

Kieso, Donald E., et al. *Intermediate Accounting.* Wiley, 2016.

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