A Case by Case Exploration of Accountancy Issues in Corporate Reporting

By

Christopher L'Chaun Feazell

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 2018

Approved by

____

Advisor: Dr. Victoria Dickinson

____

Reader: Dr. W. Mark Wilder

ABSTRACT

CHRISTOPHER L'CHAUN FEAZELL: A Case By Case Exploration of Accountancy Issues in Corporate Reporting

(Under the direction of Dr. Victoria Dickinson)

The following are solutions to a series of cases based on relevant and prevalent accounting issues in corporate financial reporting. Each case was completed in partial requirement of the honors ACCY 420 course at the University of Mississippi. The ACCY 420 course was an academic year long course, spanning the fall 2016 and spring 2017 semesters. Each case was focused on a specific accountancy issue in corporate reporting. Some cases are directly related to public companies whereas others are specific to the accountancy issue. Accordingly, each case is different. Some cases involve a combination of ratio analysis, the preparation of journal entries financial statements, and professional judgement. Others, involve one or more of the latter elements.

Table of Contents

Accy 420 Case 1 Solution

Home Heaters:
Financial Analysis and Comparison of Eads Heater, Inc. to Glenwood Heating, Inc.

Prepared by Christopher Feazell

I. Executive Summary

Below are comparable financial ratio analysis for two companies, Eads Heater, Inc and Glenwood Heating, Inc. Appendices A and B contain financial statements that reflect the economic transactions that occurred during year one of operations for both companies. These transactions serve as the basis for my ratio calculations, analysis and conclusions. I have written an analysis and recommendation concerning the profitability of both companies. In short, Glenwood Heating, Inc, overall, has greater profitability ratios as compared to Eads Heater, Inc, therefore making Glenwood Heating, Inc a better company for which to invest or to lend.

II. Analysis and Recommendation

After analyzing the results of the financial performance of both Glenwood Heating, Inc and Ead's Heater, Inc.in their first fiscal year and using my best professional judgement, I would recommend investing in or loaning to Glenwood Heating, Inc rather than Ead's Heater, Inc. While Ead's Heater, Inc retained a higher cash balance compared to that of Glenwood Heating, Inc., the company's performance came short to Glenwood's; Glenwood Heating, Inc was the most profitable and efficient company overall. In fact, according to the current ratio test, which measures a firm's ability to pay its short term obligations using its short term assets, Glenwood was 4.89 times more likely to satisfy it short term obligations as compared to Eads' 4.63. In addition, Glenwood had a net income of 23 cents for each dollar of earned revenue whereas, Ead's net income per dollar of earned revenue was 18 cents. Nonetheless, considering that Glenwood's return on equity, which is the amount of net income that a shareholder gains as a percentage of its equity, is 40 percent compared to Eads' 34 percent, it is reasonable to conclude Glenwood Heating, Inc the best company in which to invest monetary resources.

III. Appendix A : Financial Statements for Glenwood Heating, Inc

Appendix A

Glenwood Heating, Inc
Journal Entries

16-Jan	Cash	Accounts Receivable	Inventory	Land	Building	Equiptment	Accounts Payable	Notes Payable	Interest Payable	Common Stock	Retained Earnings		
1	160,000									160,000			
2	400,000							400,000					
3	-420,000			70,000	350,000								
4	-80,000					80,000							
5			239,800				239,800						
6		398,500									398,500		
7	299,100	-299100											
8	-213,360						-213,360						
9	-41,000							-20,000			-21000	**Interest Exp**	
10	-34,200										-34,200	**Other Operating Expense**	
11	-23,200										-23,200	**Dividends**	
12									6,650		-6,650	**Interest expense**	
Totals:	**47,340**	**99,400**	**239,800**	**70,000**	**350,000**	**80,000**	**26,440**	**380,000**	**6,650**	**160,000**	**313,450**		

	Glenwood Heating, Inc	
	Trial Balance	
	1/31/2016	
Asset Accounts	**Dr.**	**Cr.**
Cash	47,340	
Accounts Receivable	99,400	
Inventory	239,800	
Land	70,000	
Building	350,000	
Equipment	80,000	
Liability Accounts		
Accounts Payable		26,440
Note Payable		380,000
Interest Payable		6,650
Equity Accounts		
Common Stock		160,000
Dividends	23,200	
Sales		398,500
Interest Expense	27,650	
Other Operating Expense	34,200	
Totals:	971,590	971,590

	Glenwood Heating, Inc	
	Adjusted Trial Balance	
	Part B 12/31/2016	
Accounts	**Dr.**	**Cr.**
Cash	426	
Accounts Receivable	99,400	
Allowance for Bad Debts		994
Inventory	62,800	
Land	70,000	
Building	350,000	
Accumulated Depreciation-Building		10,000
Equipment	80,000	
Accumulated Depreciation-Equipment		9,000
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Common Stock		160,000
Dividends	23,200	
Sales		398,500
Cost of Goods Sold	177,000	
Other Operating Expense	34,200	
Bad Debt Expense	994	
Depreciation Expense-Building	10,000	
Depreciation Expense-Equipment	9,000	
Rent Expense	16,000	
Interest Expense	27,650	
Provision for Income Tax	30,914	
Totals:	991,584	991,584

	Glenwood Heating, Inc	
	Statement of Cash Flows	
	January 1-December 31, 2016	
Cash Flow from Operating Activities		
Net Income		92,742
Adjustments to Reconcile Net Income to		
net cash provided by operating activities:		
Bad Debt Expense	994	
Depreciation Expense	19,000	
Inventory	-62,800	
Accounts Receivable	-99,400	
Accounts Payable	26,440	
Interest Payable	6,650	-109,116
Net cash Used by operating activities:		-16,374
Cash Flows from Investing Activities		
Land	-70,000	
Equipment	-80,000	
Building	-350,000	
Net Cash Flows Used by Investing Activities		-500,000
Cash Flows from Financing Activities		
Issuance of Note Payable	380,000	
Issuance of Common Stock	160,000	
Payment of Cash Dividends	-23,200	
Net Cash provided by Financing Activities		516,800
Net Increase in Cash		426

		Glenwood Heating, Inc	
		Statement of Changes in Stockholders' Equity	
		For the Year Ended December 31, 2016	
	Total	**Retained Earnings**	**Common Stock**
Beg. Balance	160,000	0	160,000
Net Income	92,742	92,742	0
Dividends	-23,200	-23,200	
Ending Balance	229,542	69,542	160,000

	Glenwood Heating, Inc		
	Classified Balance Sheet		
	For Year Ended December 31, 2016		
Current Assets			
Cash		426	
Accounts Receivable		99,400	
Less: Allowance For Doubtful Accounts	-994		
Inventory		62,800	
Total Current Assets			161,632
Property, Plant, and Equipment			
Land		70,000	
Building		350,000	
Less: Accumulated Depreciation-Building	-10,000		
Equipment		80,000	
Less: Accumulated Depreciation-Equipment	-9,000		
Total Property, Plant, and Equipment			481,000
Total Assets			642,632
Current Liabilities			
Accounts Payable		26,440	
Interest Payable		6,650	
Total Current Liabilities			33,090
Long-term Liabilities			
Note Payable			380,000
Total Liabilities			413,090
Stockholder's Equity			
Common Stock			160,000
Retained Earnings			69,542
Total Stockholder's Equity			229,542
Total Liabilities and Stockholder's Equity			642,632

IV. Appendix B: Financial Statements for Eads Heater, Inc.

Appendix B

16-Jan	Cash	Accounts Receivable	Inventory	Land	Building	Equiptment	Accounts Payable	Notes Payable	Interest Payable	Common Stock	Retained Earnings		
1	160,000									160,000			
2	400,000							400,000					
3	-420,000			70,000	350,000								
4	-80,000					80,000							
5			239,800				239,800						
6		398,500									398,500		
7	299,100	-299100											
8	-213,360						-213,360						
9	-41,000							-20,000			-21000	Interest Exp	
10	-34,200										-34,200	Other Operating Expense	
11	-23,200										-23,200	Dividends	
12									6,650		-6,650	Interest expense	
Totals:	**47,340**	**99,400**	**239,800**	**70,000**	**350,000**	**80,000**	**26,440**	**380,000**	**6,650**	**160,000**	**313,450**		

Ead's Heater, Inc

Journal Entries

	Eads Heater,Inc	
	Trial Balance	
	Part A 1/31/2016	
Asset Accounts	**Dr.**	**Cr.**
Cash	47,340	
Accounts Receivable	99,400	
Inventory	239,800	
Land	70,000	
Building	350,000	
Equipment	80,000	
Liability Accounts		
Accounts Payable		26,440
Notes Payable		380,000
Interest Payable		6,650
Equity Accounts		
Common Stock		160,000
Dividends	23,200	
Sales		398,500
Interest Expense	27,650	
Other Operating Expense	34,200	
Totals:	971,590	971,590

	Eads Heater, Inc	
	Adjusted Trial Balance	
	Part B 12/31/2016	
Accounts	**Dr.**	**Cr.**
Cash	7,835	
Accounts Receivable	99,400	
Allowance for Bad Debts		4,970
Inventory	51,000	
Land	70,000	
Building	350,000	
Accumulated Depreciation-Building		10,000
Equipment	80,000	
Accumulated Depreciation-Equipment		20,000
Leased Equipment	92,000	
Accumulated Depreciation-Leased Equipment		11,500
Accounts Payable		26,440
Interest Payable		6,650
Note Payable		380,000
Lease Payable		83,360
Common Stock		160,000
Dividend	23,200	
Sales		398,500
Cost of Goods Sold	188,800	
Other Operating Expense	34,200	
Bad Debt Expense	4,970	
Depreciation Expense- Building	10,000	
Depreciation Expense- Equipment	20,000	
Depreciation Expense- Leased Equipment	11,500	
Interest Expense	35,010	
Provision For Income Tax	23,505	
Totals:	1,101,420	1,101,420

	Eads Heater, Inc	
	Income Statement	
	For Year Ended December 31, 2016	
Net Sales	398,500	
Less: Cost of Goods Sold	-188,800	
Gross Profit on Sales		209, 700
Administrative Expense		
Bad Debt Expense	-4,970	
Depreciation Expense- Equipment	-20,000	
Depreciation Expense-Building	-10,000	
Depreciation Expense- Leased Equipment	-11,500	
Other Operating Expense	-34,200	
Income from Operations		129,030
Interest Expense		-35,010
Income Before Taxes		94,020
Income Tax Expense		-26,380
Net Income		70,515

	Ead's Heater, Inc	
	Classified Balance Sheet	
	For Year Ended December 31, 2016	
Current Assets		
Cash	7,835	
Accounts Receivable	99,400	
Less: Allowance for Doubtful Accounts	-4,970	
Inventory	51,000	
Total Current Assets		153,265
Property, Plant, and Equipment		
Land	70,000	
Building	350,000	
Less: Accumulated Depreciation-Building	-10,000	
Equipment	80,000	
Less: Accumulated Depreciation- Equipment	-20,000	
Leased Equipment	92,000	
Less: Accumulated Depreciation-Lease Equipment	-11,500	
Total Property, Plant, and Equipment		550,500
Total Assets		703,765
Current Liabilities		
Accounts Payable	26,440	
Interest Payable	6,650	
Lease Payable	83,360	
Total Current Liabilities		116,450
Long-term Liabilities		
Note Payable	380,000	
Total Liabilities		496,450
Stockholder's Equity		
Common Stock	160,000	
Retained Earnings	47,315	
Total Stockholder's Equity		207,315
Total Liabilities and Stockholder's Equity:		703,765

	Ead's Heater, Inc	
	Statement of Cash Flows	
	January 1- December 31, 2016	
Cash Flows from Operating Activities		
Net Income		70,515
Adjustments to Reconcile Net Income to		
net cash provided by operating activities:		
Bad Debt Expense	4970	
Depreciation Expense-Building	10,000	
Depreciation Expense-Equipment	20,000	
Depreciation Expense-Leased Equipment	11,500	
Inventory	-51,000	
Accounts Receivable	-99,400	
Accounts Payable	26,440	
Interest Payable	6,650	
Net Cash Used by Operating Activities		-325
Cash Flows From Investing Activities		
Land	-70,000	
Equipment	-80,000	
Building	-350,000	
Net Cash Used by Investing Activities		-500,000
Cash Flows From Financing Activities		
Issuance of Note Payable	380,000	
Issuance of Common Stock	160,000	
Payment of Cash Dividends	-23,200	
Net Cash Provided by Financing Activities		516,800
Net Increase In Cash		16,475

	Ead's Heater, Inc	
	Statement of Changes in Stockholder's Equity	
	For the Year Ended December 31, 2016	
Total	**Retained Earnings**	**Common Stock**
160,000		160,000
70,515	70,515	
-23,200	-23,200	
207,315	47,315	160,000

Accy 420 Case 2 Solution

Totz and Doodlez:

The Classification of Income Statement Items

Prepared by Christopher Feazell

I. Executive Summary

Totz, a high end children's clothing store, presented its financial statements for the years 2014, 2015, and 2016. The financial statements indicated that Totz's fiscal year end was January 31st. In addition to selling products, Totz brought in Doodlez is service based, providing painting, poetry, and drawing classes. Provided below is an analysis and recommendation of how the operating financial transactions should be presented on the in the income statement.

II. Analysis and Recommendation

a) This company needs to prepare a comparative income statement to project the financial changes that has occurred over the course of three fiscal years. Because the revenue generated by Totz was from products sold and Doodlez was from services provided, the net sales section should be divided into two subsections titled: "Net sales from tangible products" and "Sales from services". The FASB codification defines "Net Sales from Tangible Products" as "net sales less discounts and allowances." The revenue generated from both Totz and Doodlez should be recorded in the appropriate sections and years in order to best reflect the revenue growth that took place from fiscal year 2015 to fiscal year 2016. Net Sales – Reg S-X, Rule 5-03(b) states, "… each class which is not more than 10 percent of the sum of the items may be combined with another class." It also goes on to say that revenues from services should be stated separately. Since service revenue attributable to Doodlez was greater than 10 percent of total revenues (it was nearly 13 percent in 2016), sales for products (Totz) and services (Doodlez) should be presented on separate line items on the face of the income statement for all periods presented.

b) Totz's cost of sales calculation excludes depreciation; consequently and according to Section 255-10-S99-8 of the FASB codification, "if cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below)." Cost of Sales should be treated as operating expense under the operating section. For purpose of clarity and in efforts of ensuring that the income statement is prepared in the best understandable manner to potential creditors and investors, I recommend the terminology read: Cost of Goods Sold (exclusive of depreciation shown separately below). I, then, recommend that depreciation expense be listed underneath cost of sales as a line item, independent from the cost of sales calculation. If Totz reported gross profit excluding depreciation, it would be violating ASC 225-10-S99-8 about not reporting a subtotal that excludes depreciation. As such, Totz should not report a gross profit subtotal because the excluded depreciation is attributable to cost of sales. Indeed, the FASB codification recommends the net income calculation include the deduction of depreciation expense.

c) The recording of the gain on sale will depend on the history of the business, all of which is not disclosed in the given information. Material items such as gains or losses can be considered unusual, infrequent, both, or neither. An unusual item is defined as an "underlying event or transaction that possess a high degree of abnormality and is a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates." An infrequent item, "an underlying event or transaction that is of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates." Should the gain be realized to be both unusual in nature and infrequent in occurrence, the transaction should be disclosed in the notes of the financial statements. In order to properly place this item on the income statement, we would need to identify the reasons in which Totz relocated, whether or not it has relocated in the past, as well as whether or not it can be reasonably predicted if the business would choose to relocate again in the future. The FASB codification illustrates an example of a gain on a sale of a building as a direct result of relocation. The example reads, "A textile manufacturer with only one plant moves to another location. It has not relocated a plant in 20 years and has no plans to do so in the foreseeable future. Notwithstanding the infrequency of occurrence of the event as it relates to this particular entity, moving from one location to another is an occurrence which is a consequence of customary and continuing business activities, some of which are finding more favorable labor markets, more modern facilities, and proximity to customers or suppliers. Therefore, the criterion of unusual nature has not been met and the moving expenses (and related gains and losses) should not be reported as an extraordinary item." Gain on disposal of headquarters - Reg S-X, Rule 5-03(b)(6) states that you should include items not normally included in SG&A in this category. Further, ASC-605-10-S99-1 states, "Gains or losses from the sale of assets should be reported as 'other general expenses' … Any material item should be stated separately." Finally, ASC-360-10-45-5 states, "A gain or loss recognized on the sale of the long-lived asset (disposal group) that is not a component of an entity shall be included in income from continuing operations before income taxes in the income statement of a business entity." Taken together, the gain on the sale of the corporate headquarters should be presented as operating income.

d) Totz manufactures and sells clothing, which propagates the assumption that Totz purchases its raw materials from suppliers. Large supply companies mass produce their raw materials, and inevitably, materials are not always authentic or of desired quality. Deficiency in the composition of products often leads to legal action being taken on supply companies, often by an array of defendants, hence, a class action suit. Since Totz is a manufacturing firm and considering the nature of its operations, I contend it to be reasonably understood for a class action suit to be listed on the income statement as operating income. According to the facts presented, the costs associated with the natural fiber materials provided by the supplier are part of Totz' central operations; therefore, the gain recognized in connection with the class action settlement should be presented within operating income. Any material item should be stated separately. ASC 605-10-S99-1 indicates that the SEC believes the guidance in Reg S-X, Rule 5-03(b)(6) applies to both gains and losses (i.e., not just expenses or losses).

Accy 420 Case 3 Solution

Rocky Mountain: Properly Recording Economic Transactions

Prepared by Christopher Feazell

i. Executive Summary

Case three required us, as students to read through several economic transactions of The Rocky Mountain Company. This case required a high level of comprehension of accounting principles. Below, in appendix A, are journal entries and financial statements that I prepared to reflect all of the financial transactions that occurred in a specified period.

ii. Rocky Mountain's Journal entries and financial statements

General Ledger - Journal Entries			
Journal Entry #	**Accounts**	**Debit**	**Credit**
1	Inventories	7,500,000	
	Accounts Payable		7,500,000
	To record purchase of inventory on account.		
2	Inventories	6,000,000	
	Accrued Salaries and Wages		6,000,000
	To record factory wages incurred.		
3	Cash and Cash Equivalent	17,000,000	
	Accounts Receivable	5,000,000	
	Sales		22,000,000
	To record sales for cash and on account.		
	Cost of Sales	14,000,000	
	Inventories		14,000,000
	To record the cost of sale of inventory.		
4	Accounts Payable	8,200,000	
	Cash and Cash Equivalents		8,200,000
	To record payment of accounts to suppliers of inventory.		
5	Cash and Cash Equivalents	4,100,000	
	Accounts Receivable		4,100,000
	To record collection of receivables.		
6	Sales and Marketing Expenses	1,505,431	
	General and Administrative Expenses	2,044,569	
	Retail Operating Expenses	1,750,000	
	Cash and Cash Equivalents		2,000,000
	Other Accrued Expenses		3,300,000
	To record payment and accrual of various expenses.		
7	Accrued Salaries and Wages	6,423,789	
	Cash and Cash Equivalents		6,423,789
	To record cash payment of accrued salaries and wages.		
8	Cash and Cash Equivalents	125,000	
	Deferred Income		125,000
	To record five-year franchise fees for services.		
9	Property and Equipment, net	498,832	
	Cash and Cash Equivalents		498,832
	To record the purchase of PPE.		
10	Retained Earnings	2,407,167	
	Cash and Cash Equivalents		2,403,458
	Dividends Payable		3,709
	To record the declaration and partial payment of dividends.		

General Ledger - Adjusting Entries			
Adjusting Entry #		**Debit**	**Credit**
1	Cost of Sales	216,836	
	Inventories		216,836
	To adjust ending inventory balance to the physical count.		
2	Depreciation and Amortization Expense	698,580	
	Property and Equipment, net		698,580
	To record depreciation expense.		
3	General and Administrative Expenses	639,200	
	Retail Operating Expenses	6,956	
	Accrued Salaries and Wages		646,156
	To record wages payable.		
4	Sales	22,944,017	
	Franchise and Royalty Fees	5,492,531	
	Interest Income	27,210	
	Income Summary		28,463,758
	Income Summary	24,883,681	
	Cost of Sales		14,910,622
	Franchise Costs		1,499,477
	Sales and Marketing Expenses		1,505,431
	General and Administrative Expenses		2,422,147
	Retail Operating Expenses		1,756,956
	Depreciation and Amortization Expense		698,580
	Income Tax Expense		2,090,468
	Income Summary	3,580,077	
	Retained Earnings		3,580,077
	To close temporary accounts to Retained Earnings.		

Transaction #	Description	Classifications
1	To record purchase of inventory on account	Operating, non-cash
2	To record factory wages incurred	Operating, non-cash
3	To record sales for cash and on account	Operating
	To record the cost of sale of inventory	Operating, non-cash
4	To record payment of accounts to suppliers	Operating
5	To record collection of receivables	Operating
6	To record payment and accrual of various expenses	Operating/Operating, non-cash
7	To record cash payment of accrued salaries and wages	Operating
8	To record five-year franchise fees for services	Operating
9	To record the purchase of PPE	Investing
10	To record the declaration and partial payment of dividends	Financing
AJE #	**Description**	**Classifications**
1	To adjust ending inventory balance to the physical count	Operating, non-cash
2	To record depreciation expense	Operating, non-cash
3	To record wages payable	Operating, non-cash
4	To close temporary accounts to Retained Earnings	Not recorded on Statement of Cash Flows

Rocky Mountain Chocolate Factory Income Statement For the Year Ended February 28, 2010	
Revenues	
Sales	$ 22,944,017.00
Franchise and Royalty Fees	$ 5,492,531.00
Total Revenue	**$ 28,436,548.00**
Cost and Expenses	
Cost of Sales	$ 14,910,622.00
Franchise Costs	$ 1,499,477.00
Sales and Marketing	$ 1,505,431.00
General and Administrative Expenses	$ 2,422,147.00
Retail Operating Expenses	$ 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 Revenues and Expenses	
Interest Income	$ 27,210.00
Income Before Taxes	$ 5,670,545.00
Income Tax Expense	$ 2,090,468.00
Net Income	**$ 3,580,077.00**

Rocky Mountain Chocolate Factory Balance Sheet February 28, 2010			
Assets		**Liabilities and Stockholders' Equity**	
Current Assets		**Current Liabilities**	
Cash and Cash Equivalents	$ 3,743,092.00	Accounts Payable	$ 877,832.00
Accounts Receivable	$ 4,427,526.00	Accrued Salaries and Wages	$ 646,156.00
Notes receivable, Current	$ 91,059.00	Other Accrued Expenses	$ 946,528.00
Inventories	$ 3,281,447.00	Dividend Payable	$ 602,694.00
Deferred Income Taxes	$ 461,249.00	Deferred income	$ 220,938.00
Other Current Assets	$ 220,163.00	Deferred Income Taxes	$ 894,429.00
Total Current Assets	**$ 12,224,536.00**	**Total Current Liabilities**	**$ 3,294,148.00**
Other Assets			
Property and Equipment, net	$ 5,186,709.00		
Notes receivable, less current portion	$ 263,650.00	**Stockholders' Equity**	
Goodwill, net	$ 1,046,944.00	Common Stock	$ 180,808.00
Intangible Assets,net	$ 110,025.00	Additional paid in capital	$ 7,626,602.00
Other Long Term Assets	$ 88,050.00	Retained Earnings	$ 6,923,927.00
Total Other Assets	**$ 1,508,669.00**	**Total Stockholders' Equity**	**$ 14,731,337.00**
Total Assets	**$ 18,919,914.00**	**Total Liabilities and Stockholders' Equity**	**$ 18,919,914.00**

Accy 420 Case 4 Solution

Internal Controls

Prepared by Christopher Feazell

I. Executive Summary

This case was one in which a business presented an issue it had with theft. The owner of the business had no idea how to detect theft and sought professional advice as to how to effectively detect theft and to prevent it. Listed below are some potential fraudulent schemes and some recommendations of internal controls that the owner may implement to mitigate and prevent fraudulent behavior among employees.

II. Analysis and Recommendations

List of Fraud Schemes	Internal Control and Why?
Lucy is the only store manager employed, which allows for an opportunity to falsify documents and transactions should rationalization and pressure coincide with the opportunity.	**Separation of Duties --** By adding an additional store manager, either a co-manager or assistant manager, responsibilities such as recording daily sales and preparing bank deposits would be separate. As a result, each manager's role will be coherent with the other and separate, allowing more room for transparency.
An employee could create fake advertising receipts and pay themselves.	**Approval Authority --** Kayla or another manager needs to approve certain transactions for the other employees.
An employee could return a product that should be unreturnable (i.e. a product that has already been opened, used, etc.), and they could use the product for themselves.	**Approval Authority --** Kayla or another manager needs to approve special types of transactions in order to better keep track of sales returns, etc.
If the single credit card machine is altered, it would be easy for an employee to cover up the transaction, especially since both cash registers link to the one credit card machine.	**Documentation --** Add a second credit card machine to better keep track of credit payments made on both registers.
The store's hard copy of the receipts go missing or are altered without Kayla's knowledge.	**Documentation --** The registers send an electronic copy to Kayla and the other managers in case something happens to the

	physical copies of receipts.
Since Lucy has access to the accounting system that allows her to record sales data and prepare bank deposits, she could easily misstate these documents. For example, she could understate the cash.	**Separation of Duties --** Give someone else access to the sales data and bank deposit information. By giving another person these duties, you are making it harder for Lucy to commit a crime without the other employees noticing.
Any of the employees could have the ability to take cash from the customers by skimming them of cash at the point of sales but not reporting the transaction.	**Documentation --** Using inventory receipts would allow Kayla to see what items were sold and what amounts of cash or credit sales should be recorded in the system.
Any of the employees could have the ability to take cash from the customers by skimming them of cash at the point of sales but not reporting the transaction.	**Physical Audits --** Audits of inventory allows there to be an account of all items sold; therefore, if there is missing inventory, there should be a sale to match it.
In any possible fraud scheme without a surveillance camera system, it could be impossible to prove fraudulent activity took place if there is no proof.	**Monitoring of Controls --** Kayla should set up surveillance cameras throughout the store, and she should be the only person that has access to the surveillance system and information.
Kayla's office was not locked and therefore, all the employees had access to her office and the records stored there.	**Access Controls --** Kayla needs to lock her office or have the locks changed if she locks them frequently to ensure other employees are unable to tamper with company financial records, information, etc.
Learn of problems before they are irreparable.	**Reporting System --** Set up a web-based reporting system so employees can confidentially report problems about the store management, sales transactions, inventory counts, other employee actions, etc., if necessary.
Charge the credit card higher and take the cash difference.	**Documentation --** Match credit sales with credit receipts. Ensure that money is accounted for.
Employees could create fake receipts and pocket some of the store's money.	**Separation of Duties --** Kayla should have a third party pay the bills.

Accy 420 Case 5 Solution

Accounting for Inventory

Prepared by Christopher Feazell

Balance Sheet Analysis

i. Note 11 disclosed three types of inventory on the balance sheet: raw materials inventory, work-in-process inventory, and finished goods inventory. While the balance sheet does not specifically list the types of cost that comprise each type of inventory, I expect certain costs to comprise each. For example, I expect raw materials to be composed of purchase and storage costs. I expect work-in-process to include direct labor, indirect labor, and overhead costs. I expect the cost of the goods completed and transferred into the finished goods account to include both storage and shipping costs.

ii. Note 2 states that the inventory balance is recorded on a 'net' basis. In other words, the inventory balances are net of the estimate for obsolete and unmarketable inventory.

iii.

a) The allowance for obsolete or unmarketable inventory does not appear anywhere on the company's financial statements. However, because it is a contra account against the inventory balance and because its function a like the allowance for doubtful accounts does against the accounts receivable, I would expect it to be disclosed on the balance sheet in the same manner as the allowance for doubtful accounts.

b) Adding the ending balance of the allowance for obsolete and unmarketable inventory back into the net balance of inventories, the gross balance of inventories for 2012 would be 224,254. Utilizing the same process for 2011, adding the ending balance of 10,800 to the net balance of inventories for 2011, the gross balance of inventories would be 243,870.

c) Considering the three types of inventories and my knowledge about them as well as the allowance for obsolete and unmarketable inventory, I believe that eighty percent is attributable to finished goods, ten percent to work-in-process and ten percent raw materials.

iv. Cost of Sales 13,348

Finished Goods Inventory 13,348

Allowance for Obsolete and Unmarketable Inventory 11,628

Inventory 11,628

v.

a) The cost of finished goods sold in the current year was $572,549

b) The cost of finished goods transferred from work-in-process in the current year was $568,735

c) The cost of raw materials transferred to work-in-process in the current year was $442,068

d) The cost of raw materials purchased in the current year was $438,469

e) The amount of cashed disbursed for raw material purchases during the current year was $432,105

vi. The inventory turnover ratio for the current year, 2012, is 2.6 as computed: 585,897/222, 402= 2.6. The inventory ratio for the prior year, 2011, is 2.3 as computed: 575,226/ 250, 831.

vii. On average, it took the company 139 days in the current year and 159 days in the prior year to sell its inventory. Those computations are a product of the inventory holding period ratio, which divides 365 days by the inventory turnover ratio. The current year's inventory holding period is as computed: 365/2.6 = 139. The prior year's inventory holding period is as computed: 365/2.3= 159. Based on the latter, computations the company is becoming more efficient as it has been selling inventory quicker as evidenced by the decrease in inventory holding periods.

viii. If the reserve for obsolete inventory related solely to finished goods inventory that would mean that the company estimated roughly 7% of finished good to be obsolete. As an investor and analyst, I would have like for the company to have disclosed the amount of the allowance for obsolete inventory as well as a year's worth of the account's transactions. In addition, I would like the company to disclose the financial statement's notes in its entirety. With the notes, I would have a better comprehension of the financial statements.

Accy 420 Case 6 Solution

WorldCom: An Examination of the Balance Sheet and Capitalizing Costs

Prepared by Christopher Feazell

Balance Sheet Analysis

i. The FASB Statement of Concepts No.6 defines an asset as items owned or "controllable" by an entity that is most likely to prove economically profitable to the company as evidenced by past performance. It defines an expense as outflows that result from the use of an asset, liability or both as a direct result of the company's "central operations".

a) While the action requires special professional judgement, costs should only be capitalized, if the asset can be deduced to generate future economic benefit. The capitalization costs should be depreciated or amortized over a period of time. Future revenues from the investment of the asset should match the latter expenses; otherwise, all costs should be expensed in the period in which they are incurred.

ii. Capitalized costs are to be allocated over a particular period as either depreciation or amortization expense, decreasing the balance sheet value and increasing expense on the income statement, with the hopes that future revenues will offset the expenses.

iii. The company reported $14,739,000,000 for a grand total of line item costs.

b) Line Costs (Expense) 14,739,000,000

Cash 14,739,000,000

c) The stated line costs are costs the company reported as owed to telephone companies for their service.

iv. According to the article of the Wall Street Journal, access costs and transport costs were capitalized to asset accounts as if the costs were those that would position the asset to generate future revenues. Access costs and transport costs by definition are merely operating expenses. These costs do not meet the definition of an asset as defined by the FASB Statement of Concepts No.6.

v. PPE (Asset) 3,055,000,000

Line Costs (Expense) 3,055,000,000

When originally prepared, these costs were listed as expenses. Having being capitalized, however, these costs would appear on the balance sheet in the asset section as part of Property, Plant and Equipment

vi. The assets that were capitalized should have been depreciated each quarter. The entry to record total depreciation expense at the end of the year should have been:

Depreciation Expense 83,306,818

Accumulated Depreciation 83,306,818

vii. Considering that WorldCom had an income before taxes of 2.393 billion, adding back the 83.306 million that should have been depreciated, as calculated in part (vi), subtracting the line costs that were improperly capitalized, WorldCom should have realized a loss before taxes of 578 million Consequently, assuming a 35 percent income tax rate, they would have reaped a tax benefit of 202 million. Assuming and considering controlling and non-controlling interest, with 35,000,000 allocated to minority interest, the total net lost would have been 341 million. Hundreds of billions of dollars, the loss in net income is indeed a material amount and should have been properly reported to avoid penalization.

Accy 420 Case 7 Solution

Targa: Long-Term Liabilities

Prepared by Christopher Feazell

Analysis

In order for Targa to account for the costs associated with restructuring its business operations according to U.S. GAAP, "the Company" must first recognize and correct the mistake it made with the time frame of the communication date to affected employees. According the U.S. FASB Codification, section 420-10-25-7, "the Worker Adjustment and Retraining Notification Act, as of 2002 requires entities with 100 or more employees to notify employees 60 days in advance of covered plant closings and mass layoffs, unless otherwise specified." Therefore, Targa should have allotted more time before issuing the restructure notice to their employees, considering that the workforce reduction is expected to be completed on January 31, 2022 and information concerning the restructure was issued on December 27th, 2021.

According to section 420-10-50-1 of the FASB codification, Targa should account for the "exit or disposal activity" by reporting all relevant costs at the beginning of the period that the activity is initiated and in every interim reporting period until the disposal activity is complete in the notes of its financial statements. The disclosure should include information such as the reason for the disposal as well as the expected date of completion of the project. If for any reason, the fair value measure of a liability is immeasurable, the codification requires such information to be disclosed in the financial notes, including but not limited to the nature of the uncertainty associated with measuring the fair value of the liability. The financial notes should also include detailed information about the costs expected to be incurred as a result of the disposal; costs should be explicitly reported in the notes according to the period in which it was incurred, accompanied by a cumulative tabulation of costs incurred, summed as of each reporting period.

Targa, “The Company”, has offered employees directly affected by the company’s decision to restructure its operations an overall benefit of $2.5 million to not render service until the termination date, meaning that only employees that stay on the job until the termination date are eligible for the one-time employee benefit. According to section 420-20-30-6, “If employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, a liability for the termination benefits shall be measured initially at the communication date based on the fair value of the liability as of the termination date.” Therefore, initially, a liability of 2.5 million should be recognized on the company’s book on December 27, 2017 and updated as required by circumstances. The severance payment and the additional lump-sum payment to facility managers should also be recorded as liabilities.

The training costs of 1.5 million and the relocation cost of 500,000 should be expensed periodically, specifically, in the period in which they are incurred. Sections 420-25-14 and 420-25-15 of the FASB codification provides guidance on “other associated costs” as they relate to an exit/disposal. Specifically, in section 420-25-14, “other associated costs’ are defined as “[including] but not limited to costs to consolidate or close facilities and relocate employees.” Subsequently section 420-25-15 requires that the amount of the liability be incurred in the period in which the activity takes place. In addition, section 420-45-2 says that costs associated with an exit/disposal from a discontinuing operation should be recognized as a cost under the discontinued operations section of the income statement. Accordingly, the training and relocation costs should be reported as incurred and particularly in the discontinued operations section of the income statement.

Accy 420 Case 8 Solution

Merck: Accounting for Treasury Stock

Prepared by Christopher Feazell

a. 5.4 billion

b. 2,983 billion

c. 2,983 billion x .01= 29.8 million

d. 811 million

e. 2,172 billion

f. 125 billion

MC=Shares Outstanding X Price Per Share

ii. Paying dividends to shareholders allow companies to appeal to investors, allowing companies to appear as profitable. Normally, when dividends are dispersed share prices go down because a cash disbursement also means a decrease in cash.

iii. Companies may repurchase their own stock because the stock is undervalued-they plan on repurchasing low and reselling high. They may aim to increase EPS (and ROE), to privatize in order to thwart possible takeover attempts or to limit outside control, to provide stock for employee stock compensation plans, to make a market in the stock by creating an artificial type demand, or to provide a tax efficient distribution to shareholders.

iv. Retained Earnings 3,310,700,000

Dividends Payable 3,400,000

Cash 3,307,300,000

v.

d) Merck uses the cost method to account for treasury stock transactions.

e) According to note 11, Merck repurchased 26,500,000 shares on the open market in 2007

f) (1,429,700,000/26,500,000) 53.95; Total cost of repurchasing the stock was $1, 429,700,000 ; Repurchasing stock is a financing cash flow

g) By definition, an assets are probable future economic benefits obtained and controlled as result of past transactions or events. While there may be some economic benefits, income cannot be earned by a firm who repurchases their own stock. Therefore, it should not be included as an asset.

vi.	2007	2006
Dividends Paid	3,307,300,000	3,322,000,000
Shares Outstanding	2,172,502,884	2,167,785,445
Net Income	3,275,400,000	4,433,800,000
Total Assets	48, 350.7	44, 569.8
Operating Cash Flows	6,999,200,000	6,765, 200,000
Year End Stock Price		
Dividends Per Share	1.52	1.53
Dividend Yield	2.64%	3.65%
Dividend Payout	1.01	0.75
Dividends to Total Assets	0.07	0.07
Dividend to Operating Cash Flows	0.47	0.49

Accy 420 Case 9 Solution

Xilinx, Inc: Accounting for Stock Options

Prepared by Christopher Feazell

i. Stock options are equity incentive plans often offered to employees as compensation. It is recorded as a non-cash expense and the stock isn't issued until the stock is vested and is deemed valuable at that date. Xilinx's stock option, in particular, are aimed to attract employees, consultants and non-employee directors and to maintain the associates' interest in the overall profitability of the company.

ii. One main difference between RSU's and Stock options is that RSUs can be issued in the form of shares or cash whereas, Stock options can only be issued in the stock form. Stock options also have the propensity to be invaluable at the date of vestment as the exercise price and the market may differ. RSUs are taxed as soon as they are vested whereas stock options are taxed as they are exercised.

iii.

a) **Grant Date** - The first day of the offering period

b) **Exercise Price** -The price at which one has a right, not an obligation, to purchase stock at a specified date

c) **Vesting Period** -The period in which an employee must wait to exercise their right as prescribed in their Employee Stock Option agreement

d) **Expiration Date** - The last day a stock options contract is valid

e) **Options/RSUs granted** - An award granted to an employee providing them the right to purchase a specified amount of stock at a predetermined price at a predetermined date.

f) **Options Exercised** - The amount of stock options that are actually exercised as a result of an Employee Stock Option agreement

g) **Options/RSUs forfeited** - The amount of stock options or RSUs that are not used, hence forfeited, at the vestment date either because the optionee did not use the options or because the options may be deemed invaluable at that time.

iv. Under the terms of the employee stock purchase plan, only qualified employees can purchase 2 year purchase rights to purchase common stock at the end of each six month exercise period. Also, participation is limited to 15% of the employees' annual earnings up to a maximum of $21 thousand in a calendar year. The stock option, on the other hand, is aimed to a wider variety of people and are not limited to a certain amount. Also, stock options are used to compensate employees whereas employee stock purchase plans are not.

v. Xilinx accounts for stock based compensation based on authoritative guidance. The company records all anticipated employee equity awards at fair value as of the grant-date of the award. The cost is recorded over the service period of the reward as "compensation expense"; any other unused or "unvested" portion of awards are recorded as compensation expense as well. The company uses the straight line method to allocate stock-based compensation costs each period. Cash flows resulting from a tax benefit are recorded a financing cash flow. The exercise price assigned to stock options are always equal to the market price of the company's common stock.

vi.

a) $ 77,862

b) On the statement of income, the sum of the expense calculated in part i is spread out under the following expense accounts: "Cost of Revenues", "Research and Development Expense" and "Selling, General and Administrative Expense".

c) The 2013 expense is added back to the operating cash flow section because it was a non-cash expense.

d) While it may be a tax benefit in the future, the 2013 expense is prepaid in 2013 and is expensed as exercised.

e) Deferred Tax Asset 22,137

Income Tax Payable 22,137

vii. The article published by the Wall Street Journal discusses how stock options have become less popular in recent years and how restricted stock units have become more heavily used instead. According to the article, after the passage of tax legislation and the financial crises of 2008, many stock options are now worthless. For this reason, many employees find it easier and more valuable to issue restricted stock units.

Unlike stock options, restricted stock units give an employee the full value of the stock at the maturity date. Restricted stock units are also not subject to complex accounting and tax laws. Employees, however, may appreciate receiving stock options instead because they are more likely to generate wealth; albeit at high risk. Stock options also allow for more employees to have more control over any and all tax implications.

viii. The data is consisted with the trends discussed in the article. According to the footnotes of Xilinx's financial statements, comparing years 2010 and 2011, the number of restricted stock units granted and vested increased. In 2010, the firm vested 2,043K of restricted stock units; 1,192k were vested. In 2011, the number of restricted units granted increased to 2,977k. The number of units vested also increased, 1,543k. Similarly, the amount of stock options granted and exercised decreased between the years of 2010 and 2011. In 2010, the number of options granted was 2345k; 5704K were exercised. In 2011, 207K options were granted and 3622k were exercised; thus, the number of options granted and exercised decreased while the number of restricted stock units granted and vested increased between the years of 2010 and 2011—all of which aligns with the trends discussed in the article published in Wall Street Journal that contended that the use of restricted stock units were more prevalent today than the issuance of stock options.

Accy 420 Case 10 Solution

Revenue Recognition

Prepared by Christopher Feazell

Executive Summary

Case 10 explores a four part scenario concerning the new Revenue Recognition rules. Each "part" has five steps. Step one describes the transaction. Step two defines the performance obligation. Step three names the transaction cost. Step four links the transaction cost directly to the performance obligation. Step five reflects the appropriate journal entry to record the transaction.

Part I

Step One: In "Part 1" the contract consists of the college student walking into Bier Haus ("The Company") and ordering a large plastic cup of beer.

Step Two: In this case, with the student having paid, the performance obligation is the bartender filling the large cup with beer and handing it to the college student.

Step Three: The transaction cost is $5

Step Four: The transaction cost of $5 dollars directly correlates to the performance obligation of the beer being handed to the college student.

Step Five: Cash 5

Sales Revenue 5

Part II

Step One: In Part II, the contract includes the college student walking into the Bier Haus and ordering a large cup of beer in an Ole Miss thermal beer mug.

Step Two: The performance obligation is the bartender filling the large cup with beer and handing it to the college student.

Step Three: The transaction cost is $7

Step Four: $4.38 (7*(5/8)) of the cost should be allotted to the beer, and $2.62 (7*(3/8)) of total cost should be allocated to the mug.

Step Five: Cash 7

Sales Revenue-Beer 4.38

Sales Revenue-Mug 2.62

Part III

Step One: Bier Haus has a verbal contract with the student, conditioning that the bartender will serve the student the beer. The Bier Haus also has a written contract --as illustrated as a coupon-- to redeem 2 pretzels for the price of $2.

Step Two: The performance obligation is the bartender providing the student the beer in the mug and a coupon to redeem for 2 pretzels at a later time.

Step Three: The total transaction cost is $7

Step Four: $4.12 (7*(5/8.50)) of the cost belongs to the beer, and since the customer received the beer, that portion of the transaction should be recorded as sales revenue. $2.88, (7*(3.50/8.50)), of the cost is related to the sale of the coupon. Since the coupon is not the actual good, and the goods are still a part of the issuer's inventory, the coupon should not be considered the product; thus, the bartender has been paid for a product that he has yet to provide to the customer. Therefore, $2.88 should be recorded as unearned revenue.

Step Five:	Cash	7
	Unearned Revenue	2.88
	Sales Revenue	4.12

Part IV

Step One: The contract between Bier Haus and the college student is that the student will receive two pretzels from the cashier, as the coupon obliges two pretzels upon redemption.

Step Two: The performance obligation is the bartender giving the college student the two pretzels in exchange for the coupon.

Step Three: There is no transaction price in this case, because the transaction involving the coupon was made prior to this occurrence. The bartender will instead recognize the unearned revenue accrued as sales revenue as a result of the transaction that occurred in part III.

Step Four: No transaction price to allocate

Step Five: Unearned Revenue 2.88

Sales Revenue 2.88

Accy 420 Case 11 Solution

Zagg, Inc: Book to Tax Differences

Prepared by Christopher Feazell

i. “Pretax financial income is a financial reporting term. It also is often referred to as income before taxes, income for financial reporting purposes, or income for book purposes. Companies determine pretax financial income according to GAAP. They measure it with the objective of providing useful information to investors and creditors.” On ZAGGs income sheet, the number is 23,898,000 listed as *Income before Provision for Income Taxes*. Book income differs from taxable income because book income disregards income tax implications.

ii.

a) **Temporary tax differences-** “While many typical business transactions are accounted for identically for income tax and financial reporting purposes, there are many others subject to different income tax and accounting treatments, often leading to their being reported in different periods in financial statements than they are reported on income tax returns. The term “timing differences”, used under prior GAAP, has been superseded by the broader term “temporary differences” under current rules.” For example, a firm may receive payment for a performance obligation before it is satisfied. The amount of the prepayment will be reflected on the balance sheet but not on the Income Statement because the revenue recognition rule states that revenue should only be recognized when a performance obligation is satisfied. Because the firm will have received cash, they are obligated to report the amount received as taxable income on the tax return; thus, creating a "temporary timing difference" between the amount listed on the financial statement and the amount reported on the tax return.

b) **Permanent tax differences**- "permanent tax differences are book-tax differences in asset or liability bases that will never reverse and therefore, affect income taxes currently payable but do not give rise to deferred income taxes." Common permanent differences include: nontaxable interest revenue on municipal bonds and goodwill amortization under the purchase method for acquisitions.

c) **Statutory Tax Rate**- the statutory tax rate is the rate imposed by statute or law. This rate is usually expressed as a percentage relative to income.

d) **Effective Tax Rate**- The effective tax rate is the rate that one actually pays. Often times, due to tax deduction and credits, one never pays the full rate as expressed per the statutory tax law. For example, the statutory law may require one to pay thirty percent of their income in taxes, but after tax deductions and credits, one may end up only paying a rate of 15 percent instead.

iii. Deferred income tax liabilities are reported as part of the total income expense calculation because doing so "[provides] incremental information about future tax payments. It results from a past transaction, and it represents a future sacrifice." If companies only reported their current tax bill and disregarded the deferred income tax liability, the financial statements will not be accurately representative of the company's financial performance or financial obligations.

iv.

a) **Deferred Tax Asset**- A deferred tax asset is an accounting term that refers to a situation where a business has overpaid taxes or taxes paid in advance on its balance sheet. These taxes are eventually returned to the business in the form of tax relief, and the over-payment is, therefore, an asset for the company. A deferred tax asset can conceptually be compared to rent paid in advance or refundable insurance premiums; while the business no longer has cash on hand, it does have comparable value, and this must be reflected in its financial statements.
b) **Deferred Tax Liability**-The deferred tax liability represents a future tax payment a company is expected to make to appropriate tax authorities in the future, and it is calculated as the company's anticipated tax rate times the difference between its taxable income and accounting earnings before taxes. In essence, it can be compared to prepaying income taxes.

v. According to Keiso, Weygandt, and Warfield, "a company should reduce a deferred tax asset by a valuation allowance if, based on available evidence, it is more likely than not that it will not realize some portion or all of the deferred tax asset. "More likely than not" means a level of likelihood of at least slightly more than 50 percent." Therefore, a valuation allowance account should only be used if the firm has had past experiences in which they have consecutively and consistently had to establish such account or if the firm has current information that solidly contends that 50 percent or more of the deferred tax asset will not be realized.

vi.

a) Income Tax Expense 9,393

Net Deferred Tax Asset 8,293

Income Tax Payable 17,686

b) Income Tax Expense 9,393

Deferred Tax Asset 8,002

Deferred Tax Liability 291

Income Tax Payable 17,686

c) Effective Tax Rate= Tax Expense/Pre-Tax Income 39.3%

d) The net deferred income tax asset balance of 13,508,000 can be found on Zagg's balance sheet. The current amount due (6,912k) is listed under the current asset section. The amount that is not yet due (6,596k) is listed singularly as *deferred income tax assets*. This breakdown helps a financial user better see which portion of the asset is actually being realized as the breakdown more accurately reflects the financial standing of the company.

Accy 420 Case 12 Solution

Build a Bear: Lease Accounting

Prepared by Christopher Feazell

i. Companies lease assets rather than buy them for several reasons. They may lease to conserve cash, to receive one hundred percent financing at fixed rates, to protect against obsolescence, to reap less costly financing, to receive tax benefits, or for off-balance-sheet financing for operating leases.

ii.

a) **Operating Lease** - Ownership is retained by the lessor during and after the lease term.

b) **Capital Lease** - Ownership of the asset might be transferred to the lessee at the end of the lease term.

c) **Direct-Financing Lease** - "In substance, this type of lease, is the financing of an asset purchase by the lessee" the lessor removes the asset from its books and reclassify it as a lease receivable

d) **Sales-Type Lease** - the fair value of the leased property at the start of the lease varies from its carrying amount. This sort of lease typically involves real-estate and results in ownership being transferred to the lessee by the end of the term.

iii. It is especially important for accountants to distinguish between lease types as different lease types significantly affect the financial statements and the company's overall financial performance. Some leases, capital leases, require the lessee to record amounts on their balance sheets and others, operating leases, do not. Also, some leases are accounted for based on specific guidelines such as present value in some instances and fair market value in others. Accounting uniquely for each type of lease also helps financial statement users know what type of lease the company is currently operating under. Ultimately, distinguishing between each lease, allows for an accountant to accurately audit, prepare and report a company's financial statements.

iv.

a) Under U.S. GAAP, this lease will be classified as a capital lease because it satisfies one of the four qualifying criteria; the present value of the lease payments is greater than 90% of the property's fair value.

b) Lease Expense 100K

Cash 100K

c) ***(Year 1)*** Lease Expense 100k

Deferred Rent 100k

(Years 2-5) Lease Expense 100K

Deferred Rent 25K

Cash 125K

v.

a) The amount of rent expense on operating leases for 2009 was $45.9 million

b) This amount was disclosed in the notes of the financial statement; It would have been found under selling, general, and administration expense on the income statement.

Year	Operating Lease Amounts	PV Multiplier	PV
1	50651	0.934579439	47337.38
2	47107	0.873438728	41145.08
3	42345	0.816297877	34566.13
4	35469	0.762895212	27059.13
5	31319	0.712986179	22330.01
6	25229	0.666342224	16811.15
7	25229	0.622749742	15711.35
8	25229	0.582009105	14683.51
		SUM:	219643.7

c) PPE 219,643.7

Lease Obligation 219,643.7

d) Lease Obligation 35,275.94 (Plug)

Interest Expense 15, 375.06 (219,643.7 * .07)

Cash 50, 651

e) Depreciation Expense (219,643.7/8) 27,455.46

Accumulated Depreciation 27, 455.46

*(8 years=lease term=Useful life)

vi. Under current U.S. GAAP, Build-A-Bear could stand to reap several benefits from choosing to account for its leases as operating leases. Structured as an operating lease, Build-A-Bear would be able boast better solvency and debt covenant ratios being that no lease asset or lease obligation would appear on the company's balance sheet. The company would also avoid having to record depreciation expense. Lack of lease expense and other related expenses, the company will be able to report a higher amount of net income on the company's income statement. Overall, treating its leases as operating leases will afford a company to appear as a better financial performer than they actually may be.

vii.

a) Yes; capital lease accounting leads to weaker liquidity and solvency ratios because the asset and its associated payment obligation are recorded as an asset and liability, respectively, on the balance sheet at either the present value of the lease payments or the fair market value, whichever is lower. Whereas, liquidity and solvency ratios would be higher for operating type leases because in that case, one does not record an asset nor a liability to the balance sheet during the accounting process. Consequently, the asset base for an operating lease would be lower, thus yielding higher liquidity and solvency ratios.

b) No; after calculating the return on equity and return on assets ratio as required by this case, the performance ratios increased, having factored in interest expense. Therefore, according to this case, one may reasonably conclude that the decision to capitalize leases always yield stronger performance ratios, not weaker ones. Each ratio's percentage only increased by a hair, however, the increase in net income allowed for higher calculations.