

## A SURVEY OF FINANCIAL ACCOUNTING REPORTING

by Charles Carey Upton III

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

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*Dedicated to Dr. Charles Carey Upton, Jr. for his quintessential desire to become a lifetime learner of subjects he does not yet understand, which is paired with the yearning and the intentionality to pass that longing down to his sons.*

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## ABSTRACT

This thesis takes a survey of key accounting issues and concepts addressed in financial accounting reporting. Accountancy majors of the Sally McDonnell Barksdale Honors College were given a chance to complete their thesis before their internship of senior year by taking two classes over junior year. This thesis was constructed under the guidance of Dr. Vicki Dickinson in this discussed class. The thesis itself is a compilation of twelve different accounting cases, and each case studies various area of financial reporting.

## TABLE OF CONTENTS

|   |     |
|---|-----|
| LIST OF TABLES...                                 | vi  |
| CASE 1: HOME HEATERS...                           | 1   |
| CASE 2: MOLSON BREWING COMPANY...                 | 14  |
| CASE 3: PEARSON...                                | 23  |
| CASE 4: A GUIDE ON HOW TO COMPLETE PROBLEM 5-5... | 35  |
| CASE 5: PALFINGER AG...                           | 39  |
| CASE 6: VOLVO...                                  | 50  |
| CASE 7: TABLEAU ANALYSIS...                       | 59  |
| CASE 8: RITE AID...                               | 64  |
| CASE 9: MERCK & CO                                | 74  |
| CASE 10: STATE STREET CORPORATION                 | 81  |
| CASE 11: ZAGG, INC.                               | 89  |
| CASE 12: APPLE                                    | 96  |
| HONOR CODE AND SIGNATURE                          | 102 |

## LIST OF TABLES

|           |   |    |
|-----------|---|----|
| TABLE 1-A | Recording Basic Transactions                | 3  |
| TABLE 1-B | Glenwood Statement of Retained Earnings     | 4  |
| TABLE 1-C | Glenwood Income Statement                   | 5  |
| TABLE 1-D | Glenwood Classified Balance Sheet           | 6  |
| TABLE 1-E | Eads Statement of Retained Earnings         | 7  |
| TABLE 1-F | Eads Income Statement                       | 7  |
| TABLE 1-G | Eads Classified Balance Sheet               | 8  |
| TABLE 1-H | Mutual Beginning Trial Balance              | 9  |
| TABLE 1-I | Recording Additional Information (Glenwood) | 10 |
| TABLE 1-J | Glenwood Ending Trial Balance               | 11 |
| TABLE 1-K | Recording Additional Information (Eads)     | 12 |
| TABLE 1-L | Eads Ending Trial Balance                   | 13 |
| TABLE 3-A | T-Account #1                                | 28 |
| TABLE 3-B | T-Account #2                                | 30 |
| TABLE 3-C | T-Account #3                                | 32 |
| TABLE 3-D | Age Breakdown of Receivables                | 33 |
| TABLE 4-A | Balance Sheet Sargent Corporation           | 36 |

|  |    |
|--|----|
| TABLE 5-A: Straight Line Depreciation                | 47 |
| TABLE 5-B: Double Declining Balance Depreciation     | 47 |
| TABLE 6-A: T-Account #4                              | 55 |
| TABLE 6-B: Intangible Asset Calculation              | 56 |
| TABLE 6-C: Navistar International Comparison         | 57 |
| TABLE 6-D: Volvo Net Sales and Total Assets          | 58 |
| TABLE 6-E: R&D to Net Sales Proportion               | 58 |
| TABLE 8-A: Effective Interest Amortization Table     | 71 |
| TABLE 8-B: Straight Line Interest Amortization Table | 72 |
| TABLE 9-A: Merck's General Financial Information     | 79 |
| TABLE 9-B: Merck's Dividend's Ratios                 | 79 |

CASE 1: HOME HEATERS

EADS HEATHING, INC. VS. GLENWOOD HEATING, INC.

by Charles Carey Upton III

September 6, 2017



## INTRODUCTION: CASE 1

Two companies of Eads Heater, Inc. and Glenwood Heating, Inc. are selling home heating units and identical in quality, economic nature, and operations. In short, both companies have the same circumstances and financial transactions; however, unique managers run each of these companies. Both managers make different, but acceptable accounting decisions about the company. Table 1-A shows the basic transactions of both companies during the fiscal year. This case is not about comparing the companies themselves, but rather analyzing the different accounting decisions made by each manager. Thus, the task of this case is to approach the financial statements of both companies as a potential investor or creditor and evaluate the attractiveness of Eads and Glenwood.

## ANALYSIS SUMMARY

From the perspective of an investor, I highly recommend investing in Glenwood Heaters, Inc. over Eads Heaters, Inc. Simply put, the accounting decisions made by the manager of simply maximizes profit for investors. Glenwood has \$22,227 more net income with the same quantity of sales and costs in comparison to Eads for this fiscal year alone. Thus from a short-term perspective, Glenwood is the clear investment of choice. Furthermore, Glenwood is also the better long-term investment of the two. It currently has a bigger profit margin with the cheaper cost of goods sold and more retained earnings for the future. Moreover, Glenwood is more likely to be able to continue the precedent of dividends at a \$7.25 per share rate with its higher net income and retained earnings.

TABLE 1-A: Recording Basic Transactions

|            | Date  | Assets     |           |            |           |            | Liabilities |           |            | Equity   |            |            |
|------------|-------|------------|-----------|------------|-----------|------------|-------------|-----------|------------|----------|------------|------------|
|            |       | Cash       | A/R       | Inventory  | Land      | Building   | Equipment   | A/P       | N/P        | I/P      | C/S        | R/E        |
| 1.         | 1/2   | \$ 160,000 |           |            |           |            |             |           |            |          | \$ 160,000 |            |
| 2. (fn 1)  | 1/2   | 400,000    |           |            |           |            |             | 400,000   | 21,000     |          |            | (21,000)   |
| 3.         | 1/3   | (420,000)  |           |            | 70,000    | 350,000    |             |           |            |          |            |            |
| 4.         | 1/5   | (80,000)   |           |            |           |            | 80,000      |           |            |          |            |            |
| 5. (fn 2)  | -     |            |           | 239,800    |           |            |             | 239,800   |            |          |            |            |
| 6. (fn 3)  | -     |            | 398,500   |            |           |            |             |           |            |          |            | 398,500    |
| 7. (fn 3)  | -     | 299,100    | (299,100) |            |           |            |             |           |            |          |            |            |
| 8. (fn 3)  | -     | (213,360)  |           |            |           |            | (213,360)   |           |            |          |            |            |
| 9. (fn 3)  | 9/30  | (41,000)   |           |            |           |            |             | (20,000)  | (21,000)   |          |            |            |
| 10. (fn 3) | -     | (34,200)   |           |            |           |            |             |           |            |          |            | (34,200)   |
| 11. (fn 4) | 12/1  | (23,200)   |           |            |           |            |             |           |            |          |            | (23,200)   |
| 12. (fn 5) | 12/31 |            |           |            |           |            |             |           | 6,650      |          |            | (6,650)    |
| Totals:    |       | \$ 47,340  | \$ 99,400 | \$ 239,800 | \$ 70,000 | \$ 350,000 | \$ 80,000   | \$ 26,440 | \$ 380,000 | \$ 6,650 | \$ 160,000 | \$ 313,450 |

Total Assets = \$ 886,540 ✓

Total Liabilities + Equity = \$ 886,540 ✓

Footnote 1: 20 year, 7 percent note payable. Payment of \$20,000 principle plus interest due September 30th of each year.

Footnote 2: Combined Transaction of 5 different purchases from January 10th to October 30th.

Footnote 3: Combined Transactions throughout the year

Footnote 4: (3,200 shares of Common Stock) x (\$7.25) = \$23,200

Footnote 5: ((((\$380,000 x 7% interest rate) / 12 months) x 3 months) = \$6,650

Similarly, Glenwood is better venture for potential creditors. For one, Eads has more liabilities already in play. Eads has an additional \$83,360 liability because of an accounting method choice with respect to its leased equipment. Frankly, neither of these companies are in a good position to pay off any sizable loan; there is still an outstanding note payable with a balance of \$380,000 principal. With a relatively small net income for both companies, there are no guarantees that any creditor would get their money back, much less interest. In summary, Glenwood Heaters, Inc. is the easily choice for investors, and although neither are great choices for creditors, Glenwood again is the better choice to lend money to over Eads Heaters, Inc. The remainder of the case is the created financial statements based on the financial information given in the case. Glenwood's financial statements are shown first, followed by Ead's financial statements.

TABLE 1-B: Glenwood Statement of Retained Earnings  
For Year Ended December 31st, 20X1

|                                  |                      |
|----------------------------------|----------------------|
| Retained Earnings, January 1st   | \$ -                 |
| Add: Net Income                  | 92,742               |
|                                  | <u>92,742</u>        |
| Less: Dividends                  | (23,200)             |
| Retained Earnings, December 31st | <u><u>69,542</u></u> |

TABLE 1-C: Glenwood Income Statement  
For The Year Ended December 31st, 20X1

|                                  |           |          |                         |
|----------------------------------|-----------|----------|-------------------------|
| <b>Sales</b>                     |           |          |                         |
| Sales Revenue                    |           |          | \$ 398,500              |
| Less: Sales Discounts            |           |          | -                       |
| Returns and Allowances           |           |          | 994                     |
| Net Sales                        |           |          | <u>397,506</u>          |
| <b>Cost of Goods Sold</b>        |           |          | <u>177,000</u>          |
| <b>Gross Profit</b>              |           |          | <u>220,506</u>          |
| <b>Operating Expenses</b>        |           |          |                         |
| Selling Expenses                 |           |          |                         |
| Other Operating Expenses         |           | \$34,200 |                         |
| Administrative Expenses          |           |          |                         |
| Rent Expense                     | \$ 16,000 |          |                         |
| Depreciation Expense-Building    | 10,000    |          |                         |
| Depreciation Expense-Equipment   | 9,000     | 35,000   |                         |
| Total Expenses                   |           |          | <u>69,200</u>           |
| <b>Income from Operations</b>    |           |          | 151,306                 |
| <b>Other Revenues and Gains</b>  |           |          | -                       |
| <b>Other Expenses and Losses</b> |           |          |                         |
| Interest on bonds and notes      |           |          | <u>27,650</u>           |
| <b>Income before Income Tax</b>  |           |          | 123,656                 |
| Income Tax Expense               |           |          | <u>30,914</u>           |
| <b>Net Income for the year</b>   |           |          | <u><u>\$ 92,742</u></u> |

TABLE 1-D: Glenwood Classified Balance Sheet  
For Year Ended December 31st, 20X1

| <u>Assets</u>  |                 |                          |
|--|-----------------|--------------------------|
| <b>Current Assets</b>                                  |                 |                          |
| Cash   |                 | \$ 426                   |
| Investments (AFS)                                      |                 | -                        |
| Accounts Receivable                                    | \$ 99,400       |                          |
| Less: Allowance for Doubtful Accounts                  | <u>(994)</u>    |                          |
| Net Account Receivables                                |                 | 98,406                   |
| Inventories-FIFO                                       |                 | <u>62,800</u>            |
| Total Current Assets                                   |                 | \$ 161,632               |
| <b>Property, Plant, and Equipment</b>                  |                 |                          |
| Land-at cost   |                 | 70,000                   |
| Building-at cost                                       | 350,000         |                          |
| Less: Acc. Depreciation-Building                       | <u>(10,000)</u> | 340,000                  |
| Equipment  | 80,000          |                          |
| Less: Acc. Depreciation-Equipment                      | <u>(9,000)</u>  | 71,000                   |
| Total Property, Plant, and Equipment                   |                 | <u>\$ 481,000</u>        |
| <b>Total Assets</b>                                    |                 | <u><u>\$ 642,632</u></u> |
| <br><b><u>Liabilities and Stockholder's Equity</u></b> |                 |                          |
| <b>Current Liabilities</b>                             |                 |                          |
| Accounts Payable                                       | \$ 26,440       |                          |
| Interest Payable                                       | 6,650           |                          |
| Current Portion of Note Payable                        | <u>26,600</u>   |                          |
| Total Current Liabilities                              |                 | 59,690                   |
| <b>Long Term Debt</b>                                  |                 |                          |
| Notes Payable, 20 year, 7%                             |                 | <u>353,400</u>           |
| <b>Total Liabilities</b>                               |                 | \$ 413,090               |
| <b>Stockholder's Equity</b>                            |                 |                          |
| Common Stock of 3,200 shares                           | \$ 160,000      |                          |
| Retained Earnings                                      | 69,542          |                          |
| Accumulated Other Comprehensive Income                 | -               |                          |
| Less: Treasury Stock                                   | <u>-</u>        |                          |
| <b>Total Stockholder's Equity</b>                      |                 | <u>229,542</u>           |
| <b>Total Liabilities and Stockholder's Equity</b>      |                 | <u><u>\$ 642,632</u></u> |

TABLE 1-E: Eads Statement of Retained Earnings  
For Year Ended December 31st, 20X1

|                                  |                      |
|----------------------------------|----------------------|
| Retained Earnings, January 1st   | \$ -                 |
| Add: Net Income                  | 70,515               |
| Less: Dividends                  | <u>23,200</u>        |
| Retained Earnings, December 31st | <u><u>47,315</u></u> |

TABLE 1-F: Eads Income Statement  
For The Year Ended December 31st, 20X1

|                                       |        |                 |                         |
|---------------------------------------|--------|-----------------|-------------------------|
| <b>Sales</b>                          |        |                 |                         |
| Sales Revenue                         |        |                 | \$ 398,500              |
| Less: Sales Discounts                 |        |                 | -                       |
| Returns and Allowances                |        |                 | <u>(4,970)</u>          |
| Net Sales                             |        |                 | 393,530                 |
| <b>Cost of Goods Sold</b>             |        |                 | <u>(188,800)</u>        |
| <b>Gross Profit</b>                   |        |                 | 204,730                 |
| <b>Operating Expenses</b>             |        |                 |                         |
| Selling Expenses                      |        |                 |                         |
| Other Operating Expenses              |        | \$ 34,200       |                         |
| Administrative Expenses               |        |                 |                         |
| Depreciation Expense-Building         | 10,000 |                 |                         |
| Depreciation Expense-Equipment        | 20,000 |                 |                         |
| Depreciation Expense-Leased Equipment | 11,500 | 41,500          |                         |
| Total Expenses                        |        |                 | <u>75,700</u>           |
| <b>Income from Operations</b>         |        |                 | 129,030                 |
| <b>Other Revenues and Gains</b>       |        |                 | 0                       |
| <b>Other Expenses and Losses</b>      |        |                 |                         |
| Interest on bonds and notes           |        | 27,650          |                         |
| Interest Expense on Leased Equipment  |        | <u>\$ 7,360</u> | <u>35,010</u>           |
| <b>Income before Income Tax</b>       |        |                 | 94,020                  |
| Income Tax Expense                    |        |                 | 23,505                  |
| <b>Net Income for the year</b>        |        |                 | <u><u>\$ 70,515</u></u> |

TABLE 1-G: Eads Classified Balance Sheet  
For Year Ended December 31st, 20X1

| <u>Assets</u>                                     |                 |                          |
|---|-----------------|--------------------------|
| <b>Current Assets</b>                             |                 |                          |
| Cash  |                 | \$ 7,835                 |
| Investments (AFS)                                 |                 | -                        |
| Accounts Receivable                               | \$ 99,400       |                          |
| Less: Allowance for Doubtful Accounts             | <u>(4,970)</u>  |                          |
| Net Account Receivables                           |                 | 94,430                   |
| Inventories-LIFO                                  |                 | <u>51,000</u>            |
| Total Current Assets                              |                 | \$ 153,265               |
| <b>Property, Plant, and Equipment</b>             |                 |                          |
| Land-at cost                                      |                 | 70,000                   |
| Building-at cost                                  | 350,000         |                          |
| Less: Acc. Dep.-Building                          | <u>(10,000)</u> | 340,000                  |
| Equipment   | 80,000          |                          |
| Less: Acc. Dep.-Equipment                         | <u>(20,000)</u> | 60,000                   |
| Leased Equipment                                  | 92,000          |                          |
| Less: Acc. Dep.-Leased Equipment                  | <u>(11,500)</u> | 80,500                   |
| Total Property, Plant, and Equipment              |                 | <u>\$ 550,500</u>        |
| <b>Total Assets</b>                               |                 | <u><u>703,765</u></u>    |
| <u>Liabilities and Stockholder's Equity</u>       |                 |                          |
| <b>Current Liabilities</b>                        |                 |                          |
| Accounts Payable                                  | \$ 26,440       |                          |
| Interest Payable                                  | <u>6,650</u>    |                          |
| Total Current Liabilities                         |                 | 33,090                   |
| <b>Long Term Debt</b>                             |                 |                          |
| Notes Payable, 20 year, 7%                        |                 | 380,000                  |
| Lease Payable                                     |                 | 83,360                   |
| <b>Total Liabilities</b>                          |                 | \$ 496,450               |
| <b>Stockholder's Equity</b>                       |                 |                          |
| Common Stock of 3,200 shares                      | \$ 160,000      |                          |
| Retained Earnings                                 | 47,315          |                          |
| Accumulated Other Comprehensive Income            |                 | -                        |
| Less: Treasury Stock                              | <u>-</u>        |                          |
| <b>Total Stockholder's Equity</b>                 |                 | <u>207,315</u>           |
| <b>Total Liabilities and Stockholder's Equity</b> |                 | <u><u>\$ 703,765</u></u> |

TABLE 1-H: Mutual Beginning Trial Balance

|                          | <u>Debits</u> | <u>Credits</u> |
|--------------------------|---------------|----------------|
| Cash                     | \$ 47,340     |                |
| A/R                      | 99,400        |                |
| Inventory                | 239,800       |                |
| Land                     | 70,000        |                |
| Building                 | 350,000       |                |
| Equipment                | 80,000        |                |
| A/P                      |               | 26,440         |
| Note Payable             |               | 380,000        |
| Interest Payable         |               | 6,650          |
| C/S                      |               | 160,000        |
| Dividend                 | 23,200        |                |
| Sales                    |               | 398,500        |
| Other Operating Expenses | 34,200        |                |
| Interest Expense         | 27,650        |                |
|                          |               | <hr/>          |
| Totals:                  | 971,590       | 971,590        |
|                          |               | <hr/> <hr/>    |



TABLE 1-1: Recording Additional Information (Glenwood)

| Transactions                     | Assets    |           |            |           |            |                          | Equipment |
|----------------------------------|-----------|-----------|------------|-----------|------------|--------------------------|-----------|
|                                  | Cash      | A/R       | Inventory  | Land      | Building   | All. for Doubtful Accts. |           |
| Beginning Balances: Part A       | \$ 47,340 | \$ 99,400 | \$ 239,800 | \$ 70,000 | \$ 350,000 | \$ -                     | \$ 80,000 |
| Part B: (1) Bad Debts (see fn 1) |           |           |            |           |            | (994)                    |           |
| Part B: (2) COGS (see fn 2)      |           |           | (177,000)  |           |            |                          |           |
| Part B: (3) Depreciation         |           |           |            |           |            |                          |           |
| Building                         |           |           |            |           |            |                          |           |
| Equipment                        |           |           |            |           |            |                          |           |
| Part B: (4) Equipment            |           |           |            |           |            |                          |           |
| Rental Payment                   | (16,000)  |           |            |           |            |                          |           |
| Part B: (5) Income Tax           | (30,914)  |           |            |           |            |                          |           |
| Ending Balances:                 | \$ 426    | \$ 99,400 | \$ 62,800  | \$ 70,000 | \$ 350,000 | \$ (994)                 | \$ 80,000 |

| Transactions                     | Assets              |                 | Liabilities |          |            | Equity       |                |
|----------------------------------|---------------------|-----------------|-------------|----------|------------|--------------|----------------|
|                                  | Acc. Dep.- Building | Acc. Dep.- Equ. | A/P         | I/P      | N/P        | C/S          | R/E            |
| Beginning Balances: Part A       | \$ -                | \$ -            | \$ 26,440   | \$ 6,650 | \$ 380,000 | \$ 160,000   | \$ 313,450     |
| Part B: (1) Bad Debts (see fn 1) |                     |                 |             |          |            |              | (994)          |
| Part B: (2) COGS                 |                     |                 |             |          |            |              | (177,000)      |
| Part B: (3) Depreciation         |                     |                 |             |          |            |              |                |
| Building                         | (10,000)            |                 |             |          |            |              | (10,000)       |
| Equipment                        |                     | (9,000)         |             |          |            |              | (9,000)        |
| Part B: (4) Equipment            |                     |                 |             |          |            |              |                |
| Rental Payment                   |                     |                 |             |          |            |              | (16,000)       |
| Part B: (5) Income Tax           |                     |                 |             |          |            |              | (30,914)       |
| Ending Balances:                 | \$ (10,000)         | \$ (9,000)      | \$ 26,440   | \$ 6,650 | \$ 380,000 | \$ 160,000   | \$ 69,542      |
| Total Assets:                    | <b>642,632</b>      |                 |             |          |            | Total L + E: | <b>642,632</b> |

Footnote 1: Debit Bad Debt Expense, Credit Allowance for Doubtful Accounts for \$994

Footnote 2: FIFO: Remaining 50 units ((22 x 1,200) + (28 x 1,300)) = 62,800

TABLE 1-J: Glenwood Ending Trial Balance

|                                    | <b>Debits</b> | <b>Credits</b> |
|------------------------------------|---------------|----------------|
| Cash                               | \$ 426        |                |
| A/R                                | 99,400        |                |
| Allowance for Doubtful Accounts    |               | 994            |
| Inventory                          | 62,800        |                |
| Land                               | 70,000        |                |
| Building                           | 350,000       |                |
| Accumulated Depreciation-Building  |               | 10,000         |
| Equipment                          | 80,000        |                |
| Accumulated Depreciation-Equipment |               | 9,000          |
| A/P                                |               | 26,440         |
| I/P                                |               | 6,650          |
| N/P                                |               | 380,000        |
| C/S                                |               | 160,000        |
| Dividend                           | 23,200        |                |
| Sales                              |               | 398,500        |
| Cost of Goods Sold                 | 177,000       |                |
| Other Operating Expenses           | 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        |

TABLE 1-K: Recording Additional Information (Eads)

| Transactions                        | Assets    |            |           |           |            |                     |                          |                      |
|-------------------------------------|-----------|------------|-----------|-----------|------------|---------------------|--------------------------|----------------------|
|                                     | Cash      | Inventory  | A/R       | Land      | Building   | Acc. Dep.- Building | All. for Doubtful Accts. | Acc. Dep.- Equipment |
| Beginning Balances: Part A          | \$ 47,340 | \$ 239,800 | \$ 99,400 | \$ 70,000 | \$ 350,000 | \$ -                | \$ -                     | \$ -                 |
| Part B: (1) Bad Debts (see fn 1)    |           |            |           |           |            |                     | (4,970)                  |                      |
| Part B: (2) COGS (see fn 2)         |           | (188,800)  |           |           |            |                     |                          |                      |
| Part B: (3) Depreciation (see fn 3) |           |            |           |           |            |                     |                          |                      |
| Building                            |           |            |           |           |            | (10,000)            |                          |                      |
| Equipment                           |           |            |           |           |            |                     |                          | (20,000)             |
| Part B: (4) Equipment (see fn 4)    |           |            |           |           |            |                     |                          |                      |
| Rental Payment                      | (16,000)  |            |           |           |            |                     |                          |                      |
| Depreciation                        | (23,505)  |            |           |           |            |                     |                          |                      |
| Part B: (5) Income Tax              | (23,505)  |            |           |           |            |                     |                          |                      |
| Ending Balances:                    | \$ 7,835  | \$ 51,000  | \$ 99,400 | \$ 70,000 | \$ 350,000 | \$ (10,000)         | \$ (4,970)               | \$ (20,000)          |

| Transactions                        | Assets         |                  |                            | Liabilities |          |            |               | Equity     |                |
|-------------------------------------|----------------|------------------|----------------------------|-------------|----------|------------|---------------|------------|----------------|
|                                     | Equipment      | Leased Equipment | Acc. Dep.-Leased Equipment | A/P         | I/P      | N/P        | Lease Payable | C/S        | R/E            |
| Beginning Balances: Part A          | \$ 80,000      | \$ -             | \$ -                       | \$ 26,440   | \$ 6,650 | \$ 380,000 | \$ -          | \$ 160,000 | \$ 313,450     |
| Part B: (1) Bad Debts (see fn 1)    |                |                  |                            |             |          |            |               |            | (4,970)        |
| Part B: (2) COGS (see fn 2)         |                |                  |                            |             |          |            |               |            | (188,800)      |
| Part B: (3) Depreciation (see fn 3) |                |                  |                            |             |          |            |               |            |                |
| Building                            |                |                  |                            |             |          |            |               |            | (10,000)       |
| Equipment                           |                |                  |                            |             |          |            |               |            | (20,000)       |
| Part B: (4) Equipment               |                | 92,000           |                            |             |          |            | 92,000        |            |                |
| Rental Payment                      |                |                  |                            |             |          |            | (8,640)       |            | (7,360)        |
| Depreciation                        |                |                  | (11,500)                   |             |          |            |               |            | (11,500)       |
| Part B: (5) Income Tax              |                |                  |                            |             |          |            |               |            | (23,505)       |
| Ending Balances:                    | \$ 80,000      | \$ 92,000        | \$ (11,500)                | \$ 26,440   | \$ 6,650 | \$ 380,000 | \$ 83,360     | \$ 160,000 | \$ 47,315      |
| Total Assets:                       | <b>703,765</b> |                  |                            |             |          |            | Total L + E:  |            | <b>703,765</b> |

Footnote 1: A/R of 99,400 x 5% = 4,970

Footnote 2: LIFO: Remaining 50 units ((40 x 1,000) + (10 x 1,100)) = 51,000

Footnote 3: Building: (300,000/30 years) = 10% straight line rate; Equipment: (1/8 a year) = .125 (x 2) = 25% DDB rate

Footnote 4: 3 different journal entries within #4. The booking of the asset, recording the down payment, and the depreciation expense.

TABLE 1-L: Eads Ending Trial Balance

|   | <b>Debits</b>       | <b>Credits</b>      |
|---|---------------------|---------------------|
| Cash                                      | \$ 7,835            |                     |
| A/R                                       | 99,400              |                     |
| Allowance for Doubtful Accounts           |                     | \$ 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              |
| A/P                                       |                     | 26,440              |
| I/P                                       |                     | 6,650               |
| N/P                                       |                     | 380,000             |
| Lease Payable                             |                     | 83,360              |
| C/S                                       |                     | 160,000             |
| Dividend                                  | 23,200              |                     |
| Sales                                     |                     | 398,500             |
| Cost of Goods Sold                        | 188,800             |                     |
| Other Operating Expenses                  | 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:                                   | <u>\$ 1,101,420</u> | <u>\$ 1,101,420</u> |

CASE 2: MOLSON BREWING COMPANY

by Charles Carey Upton III

September 20, 2017

## INTRODUCTION: CASE 2

In this case, we explore Molson Brewing Company. Molson is an international brewing company headquartered in Denver, Colorado that is responsible for well-known beers such as Coors Light, Miller Lite, Blue Moon, and Keystone. This assignment on Molson explores their income statement and the reasons for how items are presented. In the analysis of the income statement, I learned a great deal about the income statement, why it is classified, and how it is classified. Often times, the income statement is looked upon as a basic financial statement worried about the bottom line of net income, but often the numbers above the bottom line are equally important.

### PART A: WHAT ARE THE MAJOR CLASSIFICATIONS OF THE INCOME STATEMENT?

An income statement is a calculation which shows the profit or loss of an accounting unit during a specific period, providing a summary of how the profit or loss is calculated from gross revenue and expenses. It is explained more fully in part B, but the income statement reflects generally accepted accounting principles instead of a simple difference between cash received and cash paid. There are two major types of income statements: the single step income statement and the multistep income statement. The single step income statement is the simple subtraction of revenues from expenses for a bottom line net income. On the other hand, a multistep income statement may not be the simplest way for companies to report all revenues, gains, expenses, and losses, but it most accurately and deeply shows what is happening within a company.

The classifications of such a statement are defined as the sections prepared within the income statement. The first section of the income statement is the operating section. It is made up of the Sales (or Revenue), Cost of Goods Sold, Selling Expenses, and Administrative Expenses. The ultimate sum of these accounts is called Income from Operations as defined as the income from the company's core basic business operations. Predictably next is the Non-Operating Section. This segment is used for periphery revenues, gains, expenses, and losses not within the principal operations; if relevant and applicable, the non-operating section is followed by Discontinued Operation, which includes material gains or losses resulting from the disposition of a component of the business. These two sections of peripheral income or losses are totaled along with Income from operations; the sum of these is called Income before income tax. Following that subtotal, is the Income Tax section. It subtracts the calculated income tax expense from Income before income tax; this difference is called Net Income. Then if applicable, the Non-controlling interest section follows; it is the allocation of income to non-controlling interest shareholders. Lastly, the multistep income is concluded with a measurement of performance of the period called Earnings per share, which is the income earned per share in the company.

**PART B: EXPLAIN WHY, UNDER U.S. GAAP, COMPANIES ARE  
REQUIRED TO PROVIDE "CLASSIFIED" INCOME STATEMENTS.**

In the United States, publicly traded companies must report relevant financial information to two big governmental agencies: Internal Revenue Service (IRS) and

Security Exchange Commission (SEC). These two agencies define income differently. In other words, there is a difference between pre-tax income and taxable income. Thus, the agencies require different types of accounting information. The IRS is not concerned with the financial information being displayed with a relevant information that is shown with faithful representation, but rather ensuring taxes are paid in the correct amount. On the other hand, the SEC's reason for existence is to insure external users such as investors and creditors have the needed information to make necessary financial decisions. A "classified" income statement is better known as a multistep income statement and this multistep income statement was established in Part A to be thorough and complete in nature. Thus, the SEC, which is the enforcer of U.S. GAAP, requires publicly traded to release a classified income statement to better inform reasonably knowledgeable users of financial statements.

**PART C: IN GENERAL, WHY MIGHT FINANCIAL STATEMENT USERS BE  
INTERESTED IN A MEASURE OF PERSISTENT INCOME?**

Persistent Income or better known as the characteristic of Earnings Persistence continuity and durability of the current earnings. This measure is extremely relevant and important to all users of financial statements, both external and internal. Ultimately, persistent income is the most important metric of any company. Whether it be external users of investors or creditors for predicting future cash flows' consistency and time frame or internal users trying to manage the cash flows of the company both in the present and the future, accurate persistent income measurements benefit all users.



PART D: DEFINE COMPREHENSIVE INCOME AND DISCUSS HOW IT DIFFERS  
FROM NET INCOME.

Comprehensive Income is defined as any change in equity (net assets) of an entity during a period from transactions and other events and circumstances from non-owner sources. Thus, it includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. On the other hand, net income is the increase (or decrease if it is a net loss) of earnings of a business from their core operations over a period. Thus, net income is a major part of comprehensive income, but there are certain peripheral transactions that are not part of the primary operations that are included in income such as a realized gain or loss from an AFS (available for sale) security holding.

PART E: THE INCOME STATEMENT REPORTS “SALES” AND “NET SALES.”  
WHAT IS THE DIFFERENCE? WHY DOES MOLSON COORS REPORT THESE  
TWO ITEMS SEPARATELY?

Sales is total revenue from the core operation of the business, which in this case is the sale of various alcoholic beverages. Net Sales is the net of sales revenue less any indirect product costs (such as: sales returns and allowances, sales discounts, and excise taxes). An excise tax is not operating expense, but rather an indirect tax paid by the consumer in the price of the product; not added on at the cash register like a sales tax either. In the case of Molson Coors, there are no sales returns and allowances because in footnote 1 of their financial statements it states that they do not take returns on their products.

Furthermore, they make their own product in house, so there are no sales discounts from suppliers either. Thus, the net sales total is the sales revenue less the indirect excise tax. As they state in the footnotes, “Excise taxes collected from customers and remitted to tax authorities are government-imposed excise taxes on beer shipments. Excise taxes on beer shipments are shown in a separate line item in the consolidated statements of operations as a reduction of sales.”

PART F: CONSIDER THE INCOME STATEMENT ITEM “SPECIAL ITEMS, NET”  
AND INFORMATION IN NOTES 1 AND 8.

**i) In general, what types of items does Molson Coors include in this line item?**

As it explicitly states in footnote 1, Molson Coors defines special items as benefits realized or charges incurred that are not a part of core operations. In other words, if such items were included in the operational portion of the income statement. It would mislead financial statement users. Such items that Molson Coors defines as special are: infrequent or unusual items, impairment or asset abandonment-related loss, restructuring charges or other atypical employment related cost, or fees on termination of significant operating agreements and gains (losses) on disposal of investments.

**ii) Explain why the company reports these on a separate line item rather than including them with another expense item. Molson Coors classifies these special items as operating expenses. Do you concur with this classification? Explain.**

I disagree with the classification of special items as an operating expense. The method in which these special items are being reported goes against the very definition of an expense. They do not use up an asset or incur a liability involved in the entity's ongoing major or central operations. As discussed above, these special items are specifically called special, because they do not belong a part of the entity's core business. These items are reported on a separate line, because if lumped in with another expense item then such summarization would not fully disclose relevant information on the company to the financial statement user.

PART G: CONSIDER THE INCOME STATEMENT ITEM "OTHER INCOMES (EXPENSE), NET" AND THE INFORMATION IN NOTE 6. WHAT IS THE DISTINCTION BETWEEN "OTHER INCOMES (EXPENSE), NET" WHICH IS CLASSIFIED A NON-OPERATING EXPENSE, AND "SPECIAL ITEMS, NET" WHICH MOLSON COORS CLASSIFIES AS OPERATING EXPENSES?

As discussed in the previous part, I think that both special items, net and other income expense, net should both be classified as a non-operating expense. Ultimately, there should not be a distinction between the two if this is the case. Both could be reoccurring items and should not affect major or core operations. Thus, I would recommend the combination of both into a single expense line with supplementary schedules provided in the footnotes.

PART H: REFER TO THE STATEMENT OF COMPREHENSIVE INCOME.

**i) What is the amount of comprehensive income in 2013? How does this amount compare to net income in 2013?**

As shown in the statements given there is 760.2 million of Comprehensive Income and 572.5 of Net Income. These is obviously a material and rather big difference between the two incomes. The said difference will be explained in the next part.

**ii) What accounts for the difference between net income and comprehensive income in 2013? In your own words, how are the items included in Molson Coors' comprehensive income related?**

This would tell the user that there are many peripheral non-operational transactions occurring that are skewing the comprehensive income. Because these numbers are derived from non-major operations within the company one should disregard the possibility of earnings persistence or consistency of such numbers in the future incomes of Molson Coors. The items that are included in the comprehensive income statement are called dirty surplus items. These items are called that, because they do not fit in cleanly into the income statement, but rather are irregular or special benefits and charges.

PART J: CONSIDER THE INFORMATION ON INCOME TAXES IN NOTE 7.

**i) What is Molson Coors' effective tax rate in 2013?**

The effective tax rate in 2013 is given as 12.8 percent in note 7. This number is calculated as the income tax expense divided by the pretax income. Thus, 84.0 million/654.5 million gives you effective tax rate of 12.8 percent.

CASE 3: PEARSON

by Charles Carey Upton III

October 4, 2017

### INTRODUCTION: CASE 3

In this case, I investigated and analyzed the receivables of Pearson. Pearson was founded in Yorkshire, England and is an international company excelling in the learning process. It was really cool to work on this case, because I have used Pearson products multiple times in my college learning experience. A large percentage of the Pearson revenue comes through accounts receivables and the subsequent cash collection. I learned more in depth about how receivables are estimated and disclosed through the financial statements. Furthermore, I learned about how in the United Kingdom there is a different meaning for provision and other financial terms than under United States GAAP. Additionally as a note, all financial numbers in this case is stated in millions.

#### PART A: WHAT IS AN ACCOUNT RECEIVABLE? WHAT OTHER NAMES DOES THIS ASSET GO BY?

An account receivable is an oral promise of the purchaser to pay for goods and services sold. In other words, accounts receivables are short-term extensions of credit that is usually collected within 30 to 60 days. This current asset is a sub classification of trade receivables, which is the broad idea that a customer owes a company amounts for goods bought or services rendered. In these financial statements, Pearson refers to account receivables as trade receivables.

PART B: HOW DO ACCOUNTS RECEIVABLE DIFFER FROM NOTES  
RECEIVABLE?

As discussed above, Trade Receivables are the broad classification of customers owing a company an amount for goods bought or services rendered. Trade Receivables can be broken down into accounts receivable and notes receivable. We already talked about accounts receivable being the oral promise of the purchaser to pay for a good or service sold. Notes Receivable on the other hand are written promises to pay a certain sum of money on a specified future date. They can be short term or long term unlike Accounts Receivable which have a turnover of 30-60 days. Furthermore, the debt obligation of the customer does not have to arise from a sold good or service, but a note receivable can be accrued through sales, financing or other transactions.

PART C: WHAT IS A CONTRA ACCOUNT? WHAT TWO CONTRA ACCOUNTS  
ARE ASSOCIATED WITH PEARSON'S TRADE RECEIVABLES (SEE NOTE 22)?  
WHAT TYPE OF ACTIVITIES ARE CAPTURED IN EACH OF THESE CONTRA  
ACCOUNTS? DESCRIBE FACTORS THAT MANAGERS MIGHT CONSIDER  
WHEN DECIDING HOW TO ESTIMATE THE BALANCE IN EACH OF THESE  
CONTRA ACCOUNTS.

A contra account is as an account on the balance sheet that reduces either an asset, liability, or equity account. In other words, it has the opposite effect on an account. For example, Accumulated Depreciation on Equipment is a contra-asset account on the asset account of equipment. It takes book value away from the asset of equipment. The two



contra accounts that are dealt with in Pearson's trade receivables are: Provision for Bad and Doubtful Debts and Provision for Sales Returns. Pearson is a company based in the United Kingdom and a provision is synonymous with the American GAAP word for Allowance, not to be confused with the American GAAP definition of a provision being another word for an expense. Provision for Bad and Doubtful Debts is a contra-asset account, which counter acts accounts receivable an asset account. It is the expectation for some customers not to pay for an amount owed on an already sold good or service. Thus, it takes away value from account receivables. Similarly, the Provision for Sales Returns counter acts the equity account of Sales Revenue as a contra-equity account. The Provision for Sales Returns is the estimate, which is later corrected to the actual amount, that customers return a previously sold items. Managers utilize past historical trends to estimate and time of receivable outstanding to estimate chance of being paid. Additionally, notes receivable are often interest bearing while accounts receivable are not.

PART D: TWO COMMONLY USED APPROACHES FOR ESTIMATING UNCOLLECTIBLE ACCONTS RECEIVABLE ARE THE PERCENTAGE OF SALES PROCEDURE AND THE AGING OF ACCOUNTS PROCEDURE. BRIEFLY DESCRIBE THESE TWO APPROACHES. WHAT INFORMATION DO MANAGERS NEED TO DETERMINE THE ACTIVITY AND FINAL ACCOUNT BALANCE UNDER EACH APPROACH?

In a perfect world, all customers would pay all debt eventually. However, we do not live in a perfect world and such losses are a normal and necessary risk of doing business

on a credit basis. Thus, managers must estimate the amount of bad debt over all accounts receivable. The two most commonly used methods are the percentage of sales procedure and the aging of accounts procedure. In the percentage of sales procedure, managers estimate without identifying specific accounts by applying one composite uncollectible rate across all accounts receivable. Thus, managers must have the quantity and monetary value of receivables outstanding and a past historical trend to determine the composite rate to apply. The second method of estimating is the aging of accounts procedure. This way hypothesizes that the longer the receivable is the less likely it is to be paid. Thus, it has increasing percentages uncollectible the longer outstanding. In short, information needed would be the quantity and monetary value of sales for both procedures then for aging of accounts you would need the time that the receivable has been outstanding. The amount of time outstanding is irrelevant with percentage of sales method.

**PART E: IF PEARSON ANTICIPATES THAT SOME ACCOUNTS WILL BE UNCOLLECTIBLE, WHY DID THE COMPANY EXTEND CREDIT TO THOSE CUSTOMERS IN THE FIRST PLACE? DISCUSS THE RISKS THAT MANAGERS MUST CONSIDER WITH RESPECT TO ACCOUNT RECEIVABLE.**

The risk of an amount owed is an inerrant risk in the business industry. Ultimately, there is no way to know which customers will or will not pay, when a product is sold. In the same way, managers considering the risk, does not mean the risk ceases to exist, nor do they have the time or resources to individually check each account for its likeliness to be paid (also known as housekeeping). However, the manager can use historical data and

fine tune prior estimates to more accurately match bad debt expense with revenues of the period.

PART F: NOTE 22 REPORTS THE BALANCE IN PEARSON’S PROVISION FOR BAD AND DOUBTFUL DEBTS (FOR TRADE RECEIVABLES) AND REPORTS THE ACCOUNT ACTIVITY (“MOVEMENTS”) DURING THE YEAR ENDED DECEMBER 31, 2009. NOTE THAT PEARSON REFERS TO THE TRADE RECEIVABLES CONTRA ACCOUNT AS A “PROVISION.” UNDER U.S.GAAP, THE RECEIVABLES CONTRA ACCOUNT IS TYPICALLY REFERRED TO AS AN “ALLOWANCE” WHILE THE TERM PROVISION IS USED TO DESCRIBE THE CURRENT PERIOD INCOME STATEMENT CHARGE FOR UNCOLLECTIBLE ACCOUNTS (ALSO KNOWN AS BAD DEBT EXPENSE).

TABLE 3-A: T-Account #1  
Provision for Bad and Doubtful Debts

|                         |  |
|-------------------------|--|
|                         | 72 (Ending 2008 Balance)                     |
| 5 (Exchange Difference) | 26 (Income Statement Movements)              |
| 20 (Utilized)           | 3 (Acquisition through business combination) |
|                         | 76 (Ending 2009 Balance)                     |

- i) Use the information in Note 22 to complete a T-account (TABLE 3-A) that shows the activity in the provision for bad and doubtful debts account during the year. Explain, in your own words, the line items that reconcile the change in account during 2009.**

In this T-account, the beginning balance is shown as a credit (right side) because the normal balance of the provision for bad and doubtful debts. The 26

million credit is the estimate of bad and doubtful debts for the period, while the 20 million debit is the actual incurred bad debt. The 5 million exchange difference is the amount that was gained from exchange. Pearson also acquired another company during the period and gained their provision for bad and doubtful debts, which explains the 3 million credit.

**ii) Prepare the journal entries that Pearson recorded during 2009 to capture 1) bad and doubtful debts expense for 2009 (that is, the “income statement movements”) and 2) the write-off of accounts receivable (that is, the amount “utilized”) during 2009. For each account in your journal entries, note whether the account is a balance sheet or income statement account.**

|   |    |
|---|----|
| 1) Bad Debt Expense                     | 26 |
| Provision for Bad and Doubtful Debts    | 26 |
| 2) Provision for Bad and Doubtful Debts | 20 |
| Account Receivables                     | 20 |

Bad Debt Expense-Income Statement account

Provision for Bad and Doubtful Debts-Balance Sheet account

Account Receivables-Balance Sheet account

**iii) In which income statement line item does the amount of 2009 estimated sales returns appear?**

Provision for Bad and Doubtful Debts is taken out of sales to provide net sales, which is reconciled in footnote 2. The income statement shows Sales, but it is the product of Net Sales.

PART G: NOTE 22 REPORTS THAT THE BALANCE IN PEARSON'S PROVISION FOR SALES RETURNS WAS £372 AT DECEMBER 31, 2008 AND £354 AT DECEMBER 31, 2009. UNDER U.S. GAAP, THIS CONTRA ACCOUNT IS TYPICALLY REFERRED TO AS AN "ALLOWANCE" AND REFLECTS THE COMPANY'S ANTICIPATED SALES RETURNS.

**i) Complete a T-account (TABLE 3-B) that shows the activity in the provision for sales returns account during the year. Assume that Pearson estimated that returns relating to 2009 Sales to be £425 million. In reconciling the change in the account, two types of journal entries are required, one to record the estimated sales returns for the period and one to record the amount of actual book returns.**

**TABLE 3-B: T-Account #2  
Provision for Sales Returns**

|              |   |
|--------------|---|
| 443 (Actual) | 372 (Ending 2008 Balance)<br>425 (Estimate) |
|              | 354 (Ending 2009 Balance)                   |

**ii) Prepare the journal entries that Pearson recorded during 2009 to capture, 1) the 2009 estimated sales returns and 2) the amount of actual book returns during 2009. In your answer, note whether each account in the journal entries is a balance sheet or income statement account.**

|                             |     |
|-----------------------------|-----|
| Sales                       | 425 |
| Provision for Sales Returns | 425 |
| Provision for Sales Returns | 443 |
| A/R                         | 443 |

Provision for Sales Returns-Balance Sheet account

Sales-Income Statement account

**iii) In which income statement line item does the amount of 2009 estimated sales returns appear?**

Provision for Sales Returns is taken out of sales to provide net sales, which is reconciled in footnote 2. The income statement shows Sales, but it is the product of Net Sales.

PART H: CREATE A T-ACCOUNT (TABLE 3-C) FOR TOTAL OR GROSS TRADE RECEIVABLES (THAT IS, TRADE RECEIVABLES BEFORE DEDUCTING THE PROVISION FOR BAD AND DOUBTFUL DEBTS AND THE PROVISION FOR SALES RETURNS). ANALYZE THE CHANGE IN THIS T-ACCOUNT BETWEEN DECEMBER 31, 2008 AND 2009. ASSUME THAT ALL SALES IN 2009 WERE ON ACCOUNT. THAT IS, THEY ARE ALL "CREDIT SALES." YOU MAY ALSO ASSUME THAT THERE WERE NO CHANGES TO THE ACCOUNT DUE TO BUSINESS COMBINATIONS OR FOREIGN EXCHANGE RATE CHANGES. PREPARE THE JOURNAL ENTRIES TO RECORD THE SALES ON ACCOUNT AND ACCOUNTS RECEIVABLE COLLECTION ACTIVITY IN THIS ACCOUNT DURING THE YEAR.

TABLE 3-C: T-Account #3  
Trade Receivables (Gross)

|                           |                             |
|---------------------------|-----------------------------|
| 1,030 (Beginning Balance) |                             |
| 5,624 (Credit Sales)      |                             |
|                           | 5,202 (Cash Collections)    |
|                           | 20 (Write off Bad Accounts) |
|                           | 443 (Sales Returns)         |
| 989 (Ending Balance)      |                             |

|       |       |       |
|-------|-------|-------|
| A/R   | 5,624 |       |
| Sales |       | 5,624 |
| Cash  | 5,202 |       |
| A/R   |       | 5,202 |

|                                      |     |     |
|--------------------------------------|-----|-----|
| Provision for Bad and Doubtful Debts | 20  |     |
| A/R                                  |     | 20  |
| Provision for Sales Returns          | 443 |     |
| A/R                                  |     | 443 |

i) **Note 22 reports information about the number of days Pearson’s trade receivables have been outstanding relative to their due date. Assume that Pearson’s auditor analyzed historical collection information to estimate the percentage of uncollectible accounts by age category and reported the estimates in the table (TABLE 3-D).**

ii) **Use these percentages and the trade receivable aging information provided in Note 22 to estimate uncollectible accounts at December 31, 2009, and complete the table. Based on your estimate, would the auditor be comfortable that the balance of the provision for bad and doubtful debt account reported in Note 22 was adequate?**

|  | Trade Receivables<br>Balance | Estimated Percent<br>Uncollectible | Accounts Estimated<br>Uncollectible |
|--|------------------------------|------------------------------------|-------------------------------------|
| Within Due Date                          | 1,096                        | 2%                                 | 22                                  |
| Up to three months past<br>due date      | 228                          | 4%                                 | 9                                   |
| Three to six months past<br>due date     | 51                           | 25%                                | 13                                  |
| Six to nine months past<br>due date      | 20                           | 50%                                | 10                                  |
| Nine to twelve months<br>past due date   | 4                            | 60%                                | 2                                   |
| More than twelve months<br>past due date | 20                           | 90%                                | 18                                  |
| Total                                    | 1,419                        | -                                  | 74                                  |



Considering the difference between the two being 2, which is immaterial in these circumstances of 1,419 receivables outstanding, I believe the auditor would be comfortable with the balance of the provision for bad and doubtful debt.

CASE 4: A GUIDE ON HOW TO COMPLETE PROBLEM 5-5

by Charles Carey Upton III

October 11, 2017

## INTRODUCTION: CASE 4

In this assignment, we are tasked to walk a student through how to solve a difficult problem in intermediate. I chose a long and complicated balance sheet problem from Chapter 5.

## THE PROBLEM

TABLE 4-A: Balance Sheet Sargent Corporation

|                   |                  |                       |                             |
|-------------------|------------------|-----------------------|-----------------------------|
| Current Assets    | 485,000          | Current Liabilities   | 380000                      |
| Investments       | 640,000          | Long Term Liabilities | 1000000                     |
| PPE               | 1,720,000        | Stockholder's Equity  | <u>1770000</u>              |
| Intangible Assets | <u>305,000</u>   | Total Liabilities and | 3150000                     |
| Total Assets      | <u>3,150,000</u> | Stockholder's Equity  | <u>                    </u> |

*Presented below is the balance sheet of Sargent Corporation for the current year 2017.*

*The following information is presented.*

- 1. The current assets section includes cash \$150,000, accounts receivable \$170,000 less \$10,000 for allowance for doubtful accounts, inventories \$180,000, and unearned rent revenue \$5,000. Inventory is stated on the lower of FIFO-cost-or-net-realizable-value.*
- 2. The investments section includes the cash surrender value of a life insurance contract \$40,000; investments in common stock, short-term \$80,000 and long-term \$270,000; and bond sinking fund \$250,000. The cost and fair value of investments in common stock are the same.*

3. *Property, plant, and equipment includes buildings \$1,040,000 less accumulated depreciation \$360,000, equipment \$450,000 less accumulated depreciation \$180,000, land \$500,000, and land held for future use \$270,000.*
4. *Intangible assets include a franchise \$165,000, goodwill \$100,000, and discount on bonds payable \$40,000.*
5. *Current Liabilities include accounts payable \$140,000, notes payable-short-term \$80,000 and long-term \$120,000, and income taxes payable \$40,000.*
6. *Long-term liabilities are composed solely of 7% bonds payable due 2025.*
7. *Stockholder's equity has preferred stock, no par value, authorized 200,000 shares, issued 70,000 shares for \$450,000; and common stock, \$1.00 par value, authorized 400,000 shares, issued 100,000 shares at an average price of \$10. In addition, the corporation has retained earnings of \$320,000.*

***Instructions:***

*Prepare a balance sheet in good form, adjusting the amounts in each balance sheet classification as affected by the information given above.*

### THE EXPLANATION

To begin, one must analyze the breakdown of each section on the given balance sheet beginning with the information given in number one for current assets. The cash, accounts receivable less the allowance for doubtful accounts, and inventory balances all belong as

they are in the current assets, because these accounts are cash or items that will be turned into cash within a year or the operating cycle of the firm whichever is longer. However, the unearned rent revenue balance of \$5,000 is a current liability that needs to be moved out of current assets.

In the investments section, the cash surrender value of a life insurance contract, investments in common stock for the long term, and a bond sinking fund are all good as long term investments. However, the short-term portion of the investments in common stock's value of \$80,000 will be realized within a year, thus it should be moved into current assets.

Property, Plant, and Equipment is made up of long term investments used in operations and all the items included fit that except for land held for future use of \$270,000. This land is not used in current operations, and should be considered an investment.

Intangible assets should be adjusted for the moving of discount on bonds payable of \$40,000 into long term liabilities as a contra liability account to the already existing bond payable within the long-term liability section.

Current Liabilities need to be changed with the moving of the long-term portion of notes payable of \$120,000 into long-term liabilities.

The long-term liabilities have already been discussed above with the already existing bond payable being good as it is.

The stockholder's equity section has accounts that all fall into that section of the balance sheet. No adjustments are needed.

CASE 5: PALFINGER AG

by Charles Carey Upton III

November 1, 2017

## INTRODUCTION

Palfinger AG as an Austrian manufacturing company produces many power heavy machinery pieces that are sold and renowned around the world. Although Palfinger makes heavy industrial equipment, that is not the equipment that this case is concerned with. There is a critical accounting difference between equipment as a product to be sold and property/plant/equipment (PPE) that is used to make said product. This assignment deals with the latter. As one analyzes the data and figures contained within this report, please note that all data is in thousands of € as it is on the financial statements. Another important note that needs to be mentioned is that because Palfinger AG is an Austrian company as discussed above, they do not report under U.S. GAAP, but rather International GAAP. As a result, there are some differences in both appearance and information contained within the financial statements.

In the analysis, I learned a great deal about how property, plant, and equipment is both subclassified and costed. There is a great deal more complexity to the accounting of a piece of machinery than just the book value and a little depreciation, much less a global company's broad spectrum of PPE. Also, I think that it is interesting how governmental grants come into play with the reduction of costs of PPE. I did not even know that there were grants for such things or how to account for them.

PART A: BASED ON THE DESCRIPTION OF PALFINGER, WHAT SORT OF PROPERTY AND EQUIPMENT DO YOU THINK THE COMPANY HAS?

Considering they are a manufacturing company that makes “hydraulic lifting, loading, and handling solutions, it is highly likely they have very specific types of property, plant, and equipment. Just to clarify, property, plant, and equipment (PPE) does not refer to the equipment that Palfinger is producing, but rather the PPE used to make the final product that Palfinger would be selling. A large company such as this would be assumed to have multiple locations for both offices and manufacturing sites. Furthermore, there will be metal manufacturing equipment, such drill presses, band saws, lathes, benders, and sheet metal fabrication machines to produce the heavy-duty metal products.

PART B: THE 2007 BALANCE SHEET SHOWS PROPERTY, PLANT, AND EQUIPMENT OF €149,900. WHAT DOES THIS NUMBER REPRESENT?

The balance sheet number of property, plant, and equipment is a two-part figure. It is the net difference of the historical cost at which the PPE was purchased less the accumulated depreciation on said PPE over its time of use. Thus, the balance sheet value of the PPE implies a net worth of these items of €149,990.

PART C: WHAT TYPE OF EQUIPMENT DOES PALFINGER REPORT IN NOTES TO THE FINANCIAL STATEMENTS?

Palfinger has three different groups of PPE disclosed in its financial statement notes: “Own buildings/investments in third-party buildings”, “plant/machinery”, “fixtures/fittings/equipment”. Additionally, Palfinger has both governmental grants, but



governmental grants are not a separate group of PPE. As it says within the notes, grants are accounted for “as reductions of the acquisition and/or manufacturing costs.”

PART D: IN THE NOTES, PALFINGER REPORTS “PREPAYMENTS AND ASSETS UNDER CONSTRUCTION.” WHAT DOES THIS SUB CATEGORY REPRESENT? WHY DOES THIS ACCOUNT HAVE NO ACCUMULATED DEPRECIATION? EXPLAIN THE RECLASSIFICATION OF €14,958 IN THIS ACCOUNT DURING 2007.

Normally, if a company buys a building, one debits building and credits cash or accounts payable. On the other hand, if a company builds a new building from scratch, then one cannot debit building and credit cash, because the building is not yet complete, nor used in operations. Thus, there is clearing account used which is called prepayments and assets under construction. This account is treated as a prepaid asset on the balance sheet; it is the location to place all costs associating with the construction and acquisition of the building before the building is complete. Thus, the total at January 1, 2017 of €10,468 is the accumulated cost of all prepayments and assets under construction. The technical rule to be able to depreciate an asset is for it to be able to be used. If the asset is not yet completed, then it cannot be depreciated.

The reclassification of prepayments and assets under construction is the ultimate end of the use of the clearing account. This reclassification means the asset under construction was completed. Thus, the new asset was debited for the total amount of cost associated with its construction, and then, the prepayments and assets under construction would be credited for the same amount. Therefore, the amount of €14,958 is the historical

cost of the new asset, which was reclassified from the prepayments and assets under construction account.

PART E: HOW DOES PALFINGER DEPRECIATE ITS PROPERTY AND EQUIPMENT? DOES THIS POLICY SEEM REASONABLE? EXPLAIN THE TRADE-OFFS MANAGEMENT MAKES IN CHOOSING A DEPRECIATION POLICY.

According to its notes, Palfinger uses straight-line depreciation. The policy of straight line depreciation is reasonable, however may not be the best accounting practice. The nature of the industry places more emphasis on the amount PPE is used versus the length of time owned. Thus, it would be better to use the activity method for the more relevant and accurate estimate of depreciation. The choice of depreciation policy by management places emphasis upon certain pieces of equipment with the allocation of cost.

PART F: PALFINGER ROUTINELY OPTS TO PERFORM MAJOR RENOVATIONS AND VALUE-ENHANCING MODIFICATIONS TO EQUIPMENT AND BUILDINGS RATHER THAN BUY NEW ASSETS. HOW DOES PALFINGER TREAT THESE EXPENDITURES? WHAT IS THE ALTERNATIVE ACCOUNTING TREATMENT?

Palfinger upon the completion of major renovation and value-enhancing modifications takes the cost and capitalizes the cost of the improvement/renovation as shown in the second note on page 8. The conceptual reasoning for the choice of this if the improved is already sufficiently depreciated to reduce its carrying value to basically zero. This is not always the case, but the difference between the approaches is immaterial. The

alternate treatment of accounting for such an event would be to charge the costs to accumulated depreciation. The logic behind the alternative method is that the improvement extends the useful life of the asset and thereby recaptures some portion or even all the past depreciation.

PART G: USE THE INFORMATION IN THE FINANCIAL STATEMENT NOTES TO ANALYZE THE ACTIVITY IN THE “PROPERTY, PLANT, AND EQUIPMENT” AND “ACCUMULATED DEPRECIATION AND IMPAIRMENT” ACCOUNTS FOR 2007. DETERMINE THE FOLLOWING AMOUNTS.

**i. The purchase of new property, plant, and equipment in fiscal 2007.**

In the note 2, the broad category is broken down into five categories: land and buildings, undeveloped, plant and machinery, other plant/fixtures/fittings/equipment, and prepayments/assets under construction. Only the addition to four of these categories would suggest a purchase of new PPE. Additions to prepayments/assets under construction would not include purchases, but rather costs associated with the construction of new PPE. During 2007, the additions in the other four PPE accounts ( $12,139 + 2,020 + 15,612 + 10,673 + 21,000$ ) totaled to 61,444. This amount is the value of new purchases of PPE.

**ii. Government grants for purchases of new property, plant, and equipment in 2007. Explain what these grants are and why they are deducted from property, plant, and equipment account.**

The information given within the case does not go into any detail about the exact nature of the grants acquired by Palfinger. However, as it states within the notes, IAS 20 clearly states that the acquisitions of grants for PPE are to be shown as reductions of costs. The amount is determined by totals of government grants in 2007 in the five categories of PPE. This amount totals to be 733 (417 + 0 + 316 + 0 + 0) in cost reduction.

### **iii. Depreciation expense for fiscal 2007.**

The total of the depreciation expense for 2007 would be calculated using the depreciation row under the 2007 fiscal year on page 8 of the financial statements. It totals to an expense of 12,557 (2,826 + 6,869 + 2,862).

### **iv. The net book value of property, plant, and equipment that Palfinger disposed of in fiscal 2007.**

The net book value is the historical cost less the accumulated depreciation for the item being analyzed. Thus, this a two-part calculation. First, there under the acquisition portion of page 8, it can be totaled that in 2007 there were 13,799 of disposals within PPE (1,409 + 0 + 6,733 + 4,936 + 721). Secondly, there was a reduction of accumulated depreciation of these disposed PPE totaling 12,298 (1,011 + 0 + 6,548 + 4,739 + 0). Therefore, the net book value of disposed PPE is 1,501 (13,799 – 12,298).

PART H: THE STATEMENT OF CASH FLOWS (NOT PRESENTED) REPORTS THAT PALFINGER RECEIVED PROCEEDS ON THE SALE OF PROPERTY, PLANT, AND EQUIPMENT AMOUNTING TO €1,655 IN FISCAL 2007. CALCULATE THE GAIN OR LOSS THAT PALFINGER INCURRED ON THIS TRANSACTION. EXPLAIN WHAT THIS GAIN OR LOSS REPRESENTS IN ECONOMIC TERMS.

According to the Statement of Cash flows being that the cash received for disposed equipment was 1,655 then the gain or loss from these transactions would be the difference of 1,655 and 1,501 from above. The difference is 154 which would be a gain on the sale of property, plant, and equipment, which would be found in the non-operating section of the income statement.

PART I: CONSIDER THE €10,673 ADDED TO “OTHER PLANT, FIXTURES, FITTINGS, AND EQUIPMENT” DURING FISCAL 2007. ASSUME THAT THESE NET ASSETS HAVE AN EXPECTED USEFUL LIFE OF FIVE YEARS AND A SALVAGE VALUE OF €1,273. PREPARE A TABLE (TABLE 5 A & TABLE 5-B) SHOWING THE DEPRECIATION EXPENSE AND NET BOOK VALUE OF THIS EQUIPMENT OVER ITS EXPECTED LIFE ASSUMING THAT PALFINGER RECORDED A FULL YEAR DEPRECIATION IN 2007 AND THE COMPANY USES:

**i. Straight Line Depreciation**

$$10,673 - 1,273 / 5 \text{ years} = 1,880 \text{ Depreciation Expense/Year}$$

**TABLE 5-A: Straight Line Depreciation**

| Year     | Depreciation Expense | Net Book Value |
|----------|----------------------|----------------|
| 1/1/2007 | -                    | 10,673         |
| 1/1/2008 | 1,880                | 8,793          |
| 1/1/2009 | 1,880                | 6,913          |
| 1/1/2010 | 1,880                | 5,033          |
| 1/1/2011 | 1,880                | 3,153          |
| 1/1/2012 | 1,880                | 1,273          |

**ii. Double Declining Balance Depreciation**

$$(10,673 - 1,273 / 5 \text{ years}) / 9,400 = 20 \% \times 2 = 40\%$$

**TABLE 5-B: Double Declining Balance Depreciation**

| Year     | Depreciation Expense | Net Book Value |
|----------|----------------------|----------------|
| 1/1/2007 | -                    | 10,673         |
| 1/1/2008 | 4,269                | 6,404          |
| 1/1/2009 | 2,562                | 3,842          |
| 1/1/2010 | 1,537                | 2,305          |
| 1/1/2011 | 922                  | 1,383          |
| 1/1/2012 | 553                  | 830            |

PART J: ASSUME THAT THE EQUIPMENT FROM PART I WAS SOLD ON THE FIRST DAY OF FISCAL 2008 FOR PROCEEDS OF €7,500. ASSUME THAT PALFINGER'S ACCOUNTING POLICY IS TO TAKE NO DEPRECIATION IN THE YEAR OF SALE.

**i. Calculate any gain or loss in this transaction assuming that the company used straight-line depreciation. What is the total income statement impact of the equipment for the two years that Palfinger owned it? Consider the gain or loss on disposal as well as the total depreciation recorded on the equipment.**

If the equipment from the straight-line portion of i) was sold on the first day of fiscal 2008, then its book value at the time would be 8,793. Thus, having it being sold for 7,500, it will yield a loss of 1,293 ( $8,793 - 7,500$ ) in the non-operating section of the income statement. During its one year of ownership, it had total of 1,880 of depreciation expense for the year of 2007, which decreased net income by 1,880. These sum to a net decrease in net income of 3,173.

**ii. Calculate any gain or loss on this transaction assuming the company used double-declining balance depreciation. What is the total income statement impact of the equipment for the two years that Palfinger owned it? Consider the gain or loss on disposal as well as the total depreciation recorded on the equipment.**

If the equipment from the double declining portion of i) was sold on the first day of fiscal 2008, then its book value at the time would be 6,404. Thus, having it being sold for 7,500, it will yield a gain of 1,096 ( $7,500 - 6,404$ ) in the non-

operating section of the income statement. During its one year of ownership, it had total of 4,269 of depreciation expense for the year of 2007, which decreased net income by 4,269. These sum to a net decrease in net income of 3,173.

**iii. Compare the total two-year income statement impact of the equipment under the two depreciation policies. Comment on the difference.**

Under both depreciation assumptions, the net income statement for sum of the disposal and depreciation totals 3,173. This is not something I was aware of that they would be identical. I assumed they would be close, and the difference between immaterial. However, the fact they yield the same income result encourages reliability as well as confidence in the accounting system. It's also just cool that they match up identically.



CASE 6: VOLVO

by Charles Carey Upton III

November 8, 2017

## INTRODUCTION

In this case, we investigate and analyze the accounting related to research and development costs or better known as R&D. Volvo is a company that manufactures and sells commercial vehicles ranging from cars to construction equipment as well as various engine components. The industry itself places such a large emphasis on future innovation and reducing environmental impacts of future products that research and development is a major factor of the business and strategic units. Thus, to remain competitive Volvo Group must invest a significant amount (roughly 13 billion Swedish Krona) each year to research and development. Being headquartered in Sweden, but a global company with operations in 180 different countries poses complexities in the application of accounting standards. In short, this case deals with how the Volvo Group should account for various R&D costs.

It was enlightening to learn so much about the research and development; this case is the first major educational interaction we have had with the topic. From the very definition of research and development costs to complex accounting judgements on the nature of costs, much was learned from this case. For example, U.S. GAAP expenses all R&D costs and International GAAP attempts to differentiate between the research and development costs to capitalize future benefits of development. With Volvo being an international company based in Sweden, we had to analyze the breakdown between the two costs. In summary, the case was instructive in the matters of research and development and gave me a new perspective on the matter. As a side note, all financial numbers in this case are in millions of SEK unless otherwise notated.

PART A: THE 2009 INCOME STATEMENT SHOWS RESEARCH AND DEVELOPMENT EXPENSES OF SEK 13,193 (MILLIONS OF SWEDISH KRONA).

WHAT TYPES OF COSTS ARE LIKELY INCLUDED IN THESE AMOUNTS?

Within research and development expenses, it can be broken down into two types of activities. Research activities are costs associated with the planned search or critical investigation aimed at discovery of new knowledge. While development costs are the translation costs of research findings or other knowledge into a plan or design for a new product or process or for a significant improvement to an existing product or process whether intended for sale or for use. R&D expenses do not include routine or periodic alterations to existing products or other internal operations. In other words, any costs not associated with regular ongoing operations

PART B: VOLVO GROUP FOLLOWS IAS 38 – INTANGIBLE ASSETS, TO ACCOUNT FOR ITS RESEARCH AND DEVELOPMENT EXPENDITURES. AS SUCH, THE COMPANY CAPITALIZED CERTAIN R&D COSTS AND EXPENSES OTHERS. WHAT FACTORS DOES VOLVO GROUP CONSIDER AS IT DECIDES WHICH R&D COSTS TO CAPITALIZE AND WHICH TO EXPENSE?

As it says within the excerpt to IAS 38, only “expenditures with a high degree of certainty will result in future financial benefits for the company” will be capitalized. To prove its future financial benefits, Volvo would consider these relevant factors to capitalize the expenditures: the technical functionality, usefulness, and practicality of new product or software.

PART C: THE R&D COSTS THAT VOLVO GROUP CAPITALIZES EACH PERIOD (LABELED PRODUCT AND SOFTWARE DEVELOPMENT COSTS) ARE AMORTIZED IN SUBSEQUENT PERIODS, SIMILAR TO OTHER CAPITAL ASSETS SUCH AS PROPERTY AND EQUIPMENT. NOTES TO VOLVO'S FINANCIAL STATEMENTS DISCLOSE THAT CAPITALIZED PRODUCT AND SOFTWARE DEVELOPMENT COSTS ARE AMORTIZED OVER THREE TO EIGHT YEARS. WHAT FACTORS WOULD THE COMPANY CONSIDER IN DETERMINING THE AMORTIZATION PERIOD FOR PARTICULAR COSTS?

Volvo currently uses a straight-line basis to amortize any all costs that need to be decreased over time. To determine the length of time to amortize, information such as useful life and impairment tests is used. For the amortization of R&D (product and software development costs) Volvo has decided to use 3-8 years.

PART D: UNDER U.S. GAAP, COMPANIES MUST EXPENSE ALL R&D COSTS. IN YOUR OPINION, WHICH ACCOUNTING PRINCIPLE (IFRS OR U.S. GAAP) PROVIDES FINANCIAL STATEMENTS THAT BETTER REFLECT COST AND BENEFITS OF PERIODIC R&D SPENDING?

To determine which accounting principle is better for financial statement users, one must understand both. Under U.S. GAAP, all research and development costs are expensed as incurred. Simple enough, right? However, under IFRS, companies investing in research and development capitalize development costs of R & D. The reasoning of the IASB behind such a difference is development costs are associated with a product or service that is in the process of being completed to be used. While research costs are associated with the

finding/researching a possible new product/service. Thus, development costs should be considered as a cost of the product itself and be capitalized/depreciated. Only downside to the conceptually stronger mindset of the IFRS is that it is not black and white where such a divide between research and development; furthermore, some development costs do not meet the qualifications of development costs to be capitalized and are expensed anyways. So, it is almost always a lot of gray versus black and white when it comes to determining the amount to capitalize/expense.

With all that being said, I think that the U.S. GAAP does a better job of reflecting actual R & D periodic spending within the financial statements. There is less ability to manage earnings through the capitalizing development costs. Users must realize, that some development costs although expensed now, may lead to future benefits, but this is a gain contingency that is not booked.

PART E: REFER TO FOOTNOTE 14 WHERE VOLVO REPORTS AN INTANGIBLE ASSET FOR “PRODUCT AND SOFTWARE DEVELOPMENT.” ASSUME THAT THE PRODUCT AND SOFTWARE DEVELOPMENT COSTS REPORTED IN FOOTNOTE 14 ARE THE ONLY R&D COSTS THAT VOLVO CAPITALIZES.

- i. What is the amount of the capitalized product and software development costs, net of accumulated amortization at the end of fiscal 2009? Which line item on Volvo Group’s balance sheet reports this intangible asset?**

Upon the assumption that the product and software developments costs reported in footnote 14 are the only R&D costs that Volvo capitalizes, there is a gross ending balance of 25,148 SEK at the end of fiscal 2009. With an ending

balance of 13,739 SEK at the end of fiscal 2009 for accumulated depreciation and amortization, the net result is a capitalized amount of product and software development costs totaling 11,409 SEK.

ii. **Create a T-account (TABLE 6-A) for the intangible asset “Product and software development,” net of accumulated amortization. Enter the opening and ending balances for fiscal 2009. Show entries in the T-account that record the 2009 capitalization (capital expenditures and amortization. To simplify the analysis, group all other account activity during the year and report the net impact as one entry in the T-account.**

iii.

TABLE 6-A: T-Account #4  
Product and Software Development (Net)

|                                 |                       |
|---------------------------------|-----------------------|
| 12,381 (Beginning 2009 Balance) |                       |
| 2,602 (Amounts Capitalized)     |                       |
|                                 | 3,126 (Amortizations) |
|                                 | 448 (Plug)            |
| 11,409 (Ending 2009 Balance)    |                       |

PART F: REFER TO VOLVO’S BALANCE SHEET, FOOTNOTES, AND THE ELEVEN-YEAR SUMMARY. ASSUME THAT THE PRODUCT AND SOFTWARE DEVELOPMENT COSTS REPORTED IN FOOTNOTE 14 ARE THE ONLY R&D COSTS THAT VOLVO CAPITALIZES.

- i. Complete the table (TABLE 6-B) below for Volvo's Product and software development intangible asset

TABLE 6-B: Intangible Asset Calculation

|   | 2007   | 2008   | 2009   |
|---|--------|--------|--------|
| 1) Product and Software development costs capitalized during the year     | 2,057  | 2,150  | 2,602  |
| 2) Total R&D Expense on the income statement                              | 11,059 | 14,348 | 13,193 |
| 3) Amortization of previously capitalized costs (included in R&D expense) | 2,357  | 2,864  | 3,126  |
| 4) Total R&D costs incurred during the year = 1 + 2 + 3                   | 15,473 | 19,362 | 18,921 |

- ii. What proportion of Total R&D costs incurred did Volvo capitalize (as product and software development intangible asset in each of the three years?

- In 2007, Volvo capitalized 2,057 of 15,473, which yields a proportion of 13.294%
- In 2008, Volvo capitalized 2,150 of 19,362, which yields a proportion of 11.104%
- In 2009, Volvo capitalized 2,602 of 18,921, which yields a proportion of 13.752%

PART G: ASSUME THAT YOU WORK AS A FINANCIAL ANALYST FOR VOLVO GROUP AND WOULD LIKE TO COMPARE VOLVO'S RESEARCH AND DEVELOPMENT EXPENDITURES TO A U.S. COMPETITOR, NAVISTAR INTERNATIONAL CORPORATION. NAVISTAR FOLLOWS U.S. GAAP THAT REQUIRES THAT ALL RESEARCH AND DEVELOPMENT COSTS BE EXPENSES IN THE YEAR THEY ARE INCURRED. YOU GATHER THE FOLLOWING INFORMATION (TABLE 6-C) FOR NAVISTAR FOR FISCAL YEAR END OCTOBER 31, 2007 THROUGH 2009.

**TABLE 6-C: Navistar International Comparison**  
(in millions of US \$)

|   | 2007   | 2008   | 2009   |
|---|--------|--------|--------|
| Total R&D costs incurred during the year expensed on the income statement | 375    | 384    | 433    |
| Net Sales, manufactured products  | 11,910 | 14,399 | 11,300 |
| Total Assets  | 11,448 | 10,390 | 10,028 |
| Operating Income before tax   | (73)   | 191    | 359    |

- i. Use the information from Volvo's eleven-year summary to complete the following table (TABLE 6-D):



TABLE 6-D: Volvo Net Sales and Total Assets

|                                  | 2007    | 2008    | 2009    |
|----------------------------------|---------|---------|---------|
| Net Sales, Industrial Operations | 285,405 | 303,667 | 218,361 |
| Total Assets from Balance Sheet  | 321,647 | 372,419 | 332,265 |

- ii. Calculate the proportion of total research and development costs incurred to net sales from operations (called, net sales from manufactured products, for Navistar) for both firms in the table below (TABLE 6-E). How does the proportion compare between the two companies?

TABLE 6-E: R&amp;D to Net Sales Proportion

|                 | Volvo   | Navistar |
|-----------------|---------|----------|
| 2007 Proportion | 0.05421 | 0.03149  |
| 2008 Proportion | 0.06376 | 0.02667  |
| 2009 Proportion | 0.08665 | 0.03832  |

2007 Calculation for Volvo: [15,473 (from first part of part f)] / [285,405 (Net Sales from table above)] = .05421

CASE 7: TABLEAU ANALYSIS

by Charles Carey Upton III

January 24, 2018

## HISTORY AND PURPOSE

Tableau began with both a problem and an opportunity. According to their website, Tableau states that “In 2020, the world will generate 50 times the amount of data as in 2011 and 75 times the number of information sources.” At the same time, this amount of data gives vast opportunities for all parties to improve and adapt. In the world of Big Data, ordinary people need to be able to understand and be able to draw conclusions from this data. This idea became the driving force behind three individuals at Stanford University, who all came together to make the software that became Tableau. It all began when the Department of Defense pitched a project to Stanford’s Computer Science Department. Chris Stolte, a Ph.D. candidate at the time, saw major potential in this project and went all in with this idea. He began to work with his Ph.D. advisor, Pat Hanrahan, on the idea that images and computer graphics significantly help people to understand data. Lastly, Christian Chabot became the face of the organization. He helped form a company, became CEO, and successfully led the data analytics start up through many major business milestones.

All this information about the origins of the company is great and all, and the much more important facts are about what the software itself does for the customers and users. Tableau boasts some of the most impressive data graphical tools in the industry. Trademarked technologies such as VizQL, Live Query Engine, and Tableau Mobile allow for ordinary people to quickly and easily access significant data analysis and subsequent conclusions. In short, this case explores the Tableau software with all its capabilities and helpfulness in accounting analysis.

## SPECIAL SKILLS

The entire point of Tableau is for it to be easy to use; no confusing codes or labyrinthine spreadsheets. As a result, there is little, if any skills necessary to begin working with Tableau. However, because Tableau is “designed for the individual, scaled for the enterprise”, there are 628 learning resources and 109 different training videos to assist in delivering powerful analytics to you as the user. For the tech specs, all you need is a computer with the operating system of at least Windows 7 or OSX 10.10. Furthermore, with the implementation of Tableau Mobile, users can get real time, powerful, and useful data to make decisions on devices such as mobile phones and tablets.

## AUDITING SCENARIOS

1. With a large global company such as McDonald’s there are seemingly countless transactions and data sources. The entire point of an audit is to verify the material correctness of the financial reporting. Tableau allows companies to internally audit and connect to all the data sources whether that be big data, a SQL database, a spreadsheet, or even cloud apps simultaneously. This allows for quicker and more efficient audits, which lowers the cost of the audit for both the auditing firm and the company itself.
2. Tableau allows for auditing firms to explore all data in a population instead of being limited by audit sampling. This allows for quicker and more assured audits.
3. The nature of an audit tends to have a large amount of collaboration and group work on the audit. Tableau has two different ways to securely share and collaborate with others. Tableau Server and Tableau Online both allow for secure sharing, whether that be on the cloud or on premise servers.

### TAX PLANNING SCENARIOS

1. Although there is not as much data as auditing and advisory for taxes, Tableau is still helpful to tax practices. Like all economic measures, taxes follow the business cycle. In other words, there are patterns to be found and patterns lead to helpful information. Tableau allows firms to analyze complex tax information to find useful trends.
2. With large national and international companies, the geographical location is very important for the tax implications of decisions. For example, in which state do companies get the biggest tax refunds? This information seems relatively small, but if one finds a trend with states or countries that are relatively generous to companies in terms of taxes, then one can take advantage of it by growing to or moving to beneficial locations.
3. Lastly, but probably most obvious is that the use of Tableau in all tax activities will speed up the process from beginning to end, which save both time and money for clients and the firm itself.

### ADVISORY SCENARIOS

1. Regardless if a company already uses the Tableau software among themselves internally or not, Tableau can be helpful to the advising firm. If they have not already connected all the data sources as described above, the auditing firm can use Tableau to speed up the audit. As the old proverb says, "time is money."
2. Advisors can use Tableau as a one stop analysis tool to simultaneously have all the data in one place and run their own analyses and evaluations of the company
3. Most importantly for advisors, they can easily and quickly display graphical trends and analyses on the information gathered in an understandable manner.

## EXECUTIVE SUMMARY

For our firm and accounting team, I believe that investing in Tableau is a worthy and important investment for the future. As it has been shown in the above scenarios, Tableau can be useful to the firm and more importantly to our clients. We will be able to provide better services to them for less just from the power of the Tableau software. Of course, the big question is how much is it going to cost us? According to their website, a server (Tableau for the entire company) is billed at \$35 per user/per month. Depending upon the size of our firm that may be relatively small or large investment, but after reading this report, I feel that you must agree me that each user would be able to go at least \$35 dollars faster on their accounting work while simultaneously providing better services to our clients.

## SOURCES

- [www.tableau.com/about/mission?utm\\_medium=homepage](http://www.tableau.com/about/mission?utm_medium=homepage)
- [https://www.tableau.com/learn/webinars/steps-improve-your-internal-audit-and-compliance-using-tableau?src=liftigniter&widget=learn-recs-li&li\\_source=LI&li\\_medium=learn-recs-li](https://www.tableau.com/learn/webinars/steps-improve-your-internal-audit-and-compliance-using-tableau?src=liftigniter&widget=learn-recs-li&li_source=LI&li_medium=learn-recs-li)
- <https://www.tableau.com/pricing>

CASE 8: RITE AID

by Charles Carey Upton III

February 11, 2018

## INTRODUCTION

Rite Aid is a massive retail pharmacy in the United States with 4,780 stores in 31 states. The company is number one in over half of the markets where it operates, and it also offers 3,300 products under the Rite Aid private brand. In fiscal 2009, Rite Aid pharmacists filled more than 300 million prescriptions, which accounted for nearly 68% of total sales. In addition, Rite Aid stores sell a myriad of other merchandise beyond pharmacist filled prescriptions. However, Rite Aid had to become funded to grow and expand to this extent. The chief way in which the company achieved this was through long-term debt. Long-term debts are liabilities or obligations that will not be paid off within the current year or operating cycle, whichever is longer.

This case strives to expand our understanding of what long-term debt is, how to account for it, and how to report it. By doing this case, I have learned about long term debt and about its different subcategories. Furthermore, the case advanced my understanding of effective interest and straight-line methods of amortization. All numbers within the case are to remain in their financial statement format of thousands.

PART A: CONSIDER THE VARIOUS TYPES OF DEBT DESCRIBED IN NOTE 11,

### INDEBTNESS AND CREDIT AGREEMENT

**i) Explain the difference between Rite Aid's secured and unsecured debt.**

**Why does Rite Aid distinguish between these two types of debt?**

In general, secured debt is debt that has assets attached to it as collateral in case that the creditor will receive if the debtor is unable to fulfill the debt obligation.

On the other hand, unsecured debt means that there is no collateral committed to



the debt. Rite Aid, distinguishes between the two types of debt for two reasons. One, it is relevant information to both future investors and creditors to know how much of the long-term debt has been tied up as collateral. And two, if Rite Aid was to go bankrupt, the secured creditors would be entitled to the collateral, before any other interested parties divvied up the remaining assets.

**ii) What does it mean for debt to be “guaranteed”? According to note 11, who has provided the guarantee for some of Rite Aid’s unsecured debt?**

A guaranteed debt is a liability that is guaranteed by a third party if the debtor cannot fulfill their debt obligation. The third party guaranteeing Rite Aid’s debts are their wholly owned subsidiaries.

**iii) What is meant by the terms “senior,” “fixed-rate,” and “convertible”?**

In the context of Note 11, senior means that the debt holders have the highest priority and right to get paid first should the firm fall into bankruptcy. Fixed-rate designates that the interest rate is remains the same or fixed throughout the life of the debt. Lastly, a convertible bond is a bond that gives the owner the right to convert their bond into equity (usually common stock) after a length of time.

**iv) Speculate as to why Rite Aid has many different types of debt with a range of interest rates.**

As the writers of this case have observed, Rite Aid has many different types of debt and interest rates. I believe they have this wide variety to diversify their debt. In the same way that investors and hedge funds diversify their

investments to not put all their metaphorical eggs in one basket, Rite Aid seems to be doing the same thing with its debt.

**PART B: CONSIDER NOTE 11, INDEBTEDNESS AND CREDIT AGREEMENT.**

**HOW MUCH TOTAL DEBT DOES RITE AID HAVE AT FEBRUARY 27, 2010?**

**HOW MUCH OF THIS IS DUE WITHIN THE COMING FISCAL YEAR?**

**RECONCILE THE TOTAL DEBT REPORTED IN NOTE 11 WITH WHAT RITE AID REPORTS ON ITS BALANCE SHEET.**

In Footnote 11, Rite Aid reports a total debt of \$6,370,899. The Total Debt for Rite Aid is calculated as the sum of long term debt, notes payable, and lease financing obligations from the balance sheet, which totals to \$6,370,899 for 2010 and reconciles the two together. Of this total debt, the total debt only the current portions will be due in the upcoming year. The only current portion of the long-term debt, notes payable, and lease financing obligations is the \$51,502 of the long-term debt and lease financing obligations.

**PART C: CONSIDER THE 7.5% SENIOR SECURED NOTES DUE MARCH 2017.**

**i) What is the face value (i.e. the principal) of these notes? How do you know?**

The face value of the note is \$500,000 and it was issued at par.

**ii) Prepare the journal entry that Rite Aid must have made when these notes were issued.**

|      |               |         |
|------|---------------|---------|
| Cash | 500,000       |         |
|      | Notes Payable | 500,000 |

**iii) Prepare the annual interest expense journal entry. Note that the interest paid on a note during the year equals the face value of the note times the stated rate (i.e., coupon rate) of the note.**

|                  |        |        |
|------------------|--------|--------|
| Interest Expense | 37,500 |        |
| Cash             |        | 37,500 |

**iv) Prepare the journal entry that Rite Aid will make when these notes mature in 2017.**

|               |         |         |
|---------------|---------|---------|
| Bonds Payable | 500,000 |         |
| Cash          |         | 500,000 |

**PART D: CONSIDER THE 9.375% SENIOR NOTES DUE DECEMBER 2015.**

**ASSUME THAT INTEREST IS PAID ANNUALLY.**

**i) What is the face value (or principal) of these notes? What is the carrying value (net book value) of these notes at February 27, 2010? Why do the two values differ?**

The face value of the 9.37% senior notes is \$410,000 and the carrying value of these notes is \$405,951. The carrying value is less than the face value, because the note was issued at a discount, and the discount is completely amortized yet.

**ii) How much interest did Rite Aid pay on these notes during the fiscal 2009?**

Rite Aid paid a cash interest payment of \$38,438, which is calculated as the face value of \$410,000 multiplied by the 9.375% stated interest rate.

**iii) Determine the total amount of interest expense recorded by Rite Aid on these notes for the year ended February 27, 2010. Note that there is a cash and a noncash portion to interest expense on these notes because they were issued at a discount. The noncash portion of interest expense is the amortization of the discount during the year (that is, the amount by which the discount decreased during the year).**

Rite Aid's total interest expense for the year ended December 31, 2009 is \$39,143. This total includes the \$38,438 cash interest with the addition of an unamortized discount of \$705.

**iv) Prepare the journal entry to record interest expense on these notes for fiscal 2009. Consider both the cash and discount (noncash) portions of the interest expense from part *iii* above.**

|                           |        |        |
|---------------------------|--------|--------|
| Interest Expense          | 39,143 |        |
| Cash                      |        | 38,438 |
| Discount on Bonds Payable |        | 705    |

**v) Compute the total rate of interest recorded for fiscal 2009 on these notes.**

The interest rate for fiscal 2009 is calculated by taking the interest expense of \$39,145 and dividing that by the beginning year carrying value of \$405,246, which yields a rate of 9.659%.

PART E: CONSIDER THE 9.75% NOTES DUE JUNE 2016. ASSUME THAT RITE AID ISSUED THESE NOTES ON JUNE 30, 2009 AND THAT THE COMPANY PAYS INTEREST ON JUNE 30<sup>TH</sup> OF EACH YEAR.

- i) **According to note 11, the proceeds of the notes at the time of issue were 98.2% of the face value of the notes. Prepare the journal entry that Rite Aid must have made when these notes were issued.**

|                           |         |         |
|---------------------------|---------|---------|
| Cash                      | 402,620 |         |
| Discount on Notes Payable | 7,380   |         |
| Notes Payable             |         | 410,000 |

- ii) **At what effective annual rate of interest were these notes issued?**

These notes were issued at an effective interest rate of 10.1212%, which was calculated in Excel using the Rate function.

- iii) **Assume that Rite Aid uses the effective interest rate method to account for this debt. Use the table (TABLE 8-A) that follows to prepare an amortization schedule for these notes. Use the last column to verify that each year's interest expense reflects the same interest *rate* even though the *expense* changes.**

TABLE 8-A: Effective Interest Amortization Table

| <b>Date</b> | <b>Cash<br/>Interest<br/>Payment</b> | <b>Interest<br/>Expense</b> | <b>Discount<br/>Amortization</b> | <b>Carrying<br/>Value</b> | <b>Effective<br/>Interest<br/>Rate</b> |
|-------------|--------------------------------------|-----------------------------|----------------------------------|---------------------------|--|
| 6/30/2009   | -                                    | -                           | -                                | 402,620.00                | 10.12%                                 |
| 6/30/2010   | 39,975.00                            | 40,750.00                   | 775                              | 403,395.00                | 10.12%                                 |
| 6/30/2011   | 39,975.00                            | 40,828.44                   | 853.44                           | 404,248.44                | 10.12%                                 |
| 6/30/2012   | 39,975.00                            | 40,914.82                   | 939.82                           | 405,188.26                | 10.12%                                 |
| 6/30/2013   | 39,975.00                            | 41,009.94                   | 1,034.94                         | 406,223.20                | 10.12%                                 |
| 6/30/2014   | 39,975.00                            | 41,114.69                   | 1,139.69                         | 407,362.89                | 10.12%                                 |
| 6/30/2015   | 39,975.00                            | 41,230.04                   | 1,255.04                         | 408,617.93                | 10.12%                                 |
| 6/30/2016   | 39,975.00                            | 41,357.07                   | 1,382.07                         | 410,000.00                | 10.12%                                 |

iv) Based on the above information, prepare the journal entry that Rite Aid would have recorded in February 27, 2010, to accrue interest expense on these notes.

|                           |        |        |
|---------------------------|--------|--------|
| Interest Expense          | 27,167 |        |
| Discount on Notes Payable |        | 517    |
| Cash                      |        | 26,650 |

v) Based on your answer to part iv, what would be the net book value of the notes at February 27, 2010?

The net book value of the notes as of February 27, 2010 is \$403,137, which is the sum of \$402,620 and \$517.

vi) Your answer to part v. will be different from the amount that Rite Aid reported because the company used the straight-line method to amortize the discount on these notes instead of the effective interest rate method. Complete the following table (TABLE 8-B) using the straight-line method to amortize

the bond discount. Use the last column in the table to record the interest rate each year. Under this method, does Rite Aid report the same interest rate on these notes each year?

TABLE 8-B: Straight Line Interest Amortization Table

|           | <b>Cash<br/>Interest<br/>Payment</b> | <b>Interest<br/>Expense</b> | <b>Discount<br/>Amortization</b> | <b>Carrying<br/>Value</b> | <b>Straight-<br/>Line<br/>Interest<br/>Rate</b> |
|-----------|--------------------------------------|-----------------------------|----------------------------------|---------------------------|---|
| 6/30/2009 |                                      |                             |                                  | 402,620.00                |   |
| 6/30/2010 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 403,674.29                | 10.19%  |
| 6/30/2011 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 404,728.57                | 10.16%  |
| 6/30/2012 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 405,782.86                | 10.14%  |
| 6/30/2013 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 406,837.14                | 10.11%  |
| 6/30/2014 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 407,891.43                | 10.08%  |
| 6/30/2015 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 408,945.71                | 10.06%  |
| 6/30/2016 | 39,975.00                            | 41,029.29                   | 1,054.29                         | 410,000.00                | 10.03%  |

vii) Compare the year-by-year difference in interest expense derived from each method. What pattern do you observe? Is the difference material in any year?

Between both the straight line and effective interest rate there is no difference in the amount discount over the life of the bond, only in individual periods, because that would affect the carrying value and subsequently how much the bond is worth. In other words, the choice between two accepted accounting practices should not affect the amount of interest paid to the owner of a bond. If the bond is sold at discount then there is a lower carrying value than the face value, which makes the discount amortized lower in the beginning and increasing over the life of the bond. This makes the interest expense subsequently decrease over time

while the straight-line method keeps both the interest amortized and interest expense the same in each period. For Rite Aid, there is no material difference between years.



CASE 9: MERCK & CO

by Charles Carey Upton III

February 23, 2018

## INTRODUCTION

This case is all about Merck & Co., Inc., which is a global pharmaceutical company that discovers, develops, manufactures and markets a broad range of products to improve human and animal health. Based in the United States, the company employs 59,800 people worldwide. However, to become such a large and dominant company, Merck had to raise a significant amount of capital. One of two primary ways to raise capital is through the issuance of stock. Stock is the representation of ownership of a portion of the company. For example, if there are 10 shares of stock and you own one, then you have ownership of a tenth of the company. The case analyzed in the ensuing pages strives to expand our understanding of how equity capital is obtained, accounted for, and analyzed. This was a great learning experience for me. There was some review with the stock and shares, but the dividend payment and subsequent ratios were enlightening and useful in analysis of the company.

### PART A: CONSIDER MERCK'S COMMON SHARES

**i) How many common shares is Merck authorized to issue?**

Merck has authorized 5,400,000,000 shares as stated in the consolidated balance sheet on page 85.

**ii) How many common shares has Merck actually issued at December 31, 2007?**

At the end of 2017, Merck had issued 2,983,508,675 shares as stated in the consolidated balance sheet on page 85.

**iii) Reconcile the number of shares issued at December 31, 2007, to the dollar value of common stock reported on the balance sheet.**

The dollar value of the common stock reported on the balance sheet is equal to the number of shares outstanding multiplied by the par value. Thus, if the issued 2,983,508,675 shares times the par value of \$.01 reconciles the dollar value of 29.8 million.

**iv) How many common shares are held in treasury at December 31, 2007?**

At the end of 2007, there are 811,005,791 shares of treasury stock being held at cost.

**v) How many common shares are outstanding at December 31, 2007?**

The number of shares outstanding will be the issued number of shares less the number held in treasury stock. As a result,  $2,983,508,675 - 811,005,791 = 2,172,502,884$  shares outstanding.

**vi) At December 31, 2007, Merck's stock price closed at \$57.61 per share. Calculate the total market capitalization of Merck on that day.**

Total market capitalization is calculated as stock price multiplied by the number of shares outstanding. As a result, the 2,172,502,884 shares outstanding times the \$57.61 per share yields a total market capitalization of \$125,157,891,147.

**PART B: WHY DO COMPANIES PAY DIVIDENDS ON THEIR COMMON OR ORDINARY SHARES? WHAT NORMALLY HAPPENS TO A COMPANY'S SHARE PRICE WHEN DIVIDENDS ARE PAID?**

Companies pay dividends to the common or ordinary shares to show consistent steady growth or to reward shareholders for an ultra-successful period. The reasoning

behind paying dividends is that if the company can afford to give cash to its shareholders, then it is in a great financial position. Thus, the stock price increases when dividends are paid, which leads to more capital investment in the company.

PART C: IN GENERAL, WHY DO COMPANIES REPURCHASE THEIR OWN  
SHARES?

Companies repurchase their own stock for two reasons. First, buying back one's own stock is a tax efficient way to disperse excess cash to shareholders. Secondly, by repurchasing one's own stock it inherently increases Earnings per share, which is a critical financial metric for gauging the earnings and overall financial health of a company.

PART D: 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.

|                   |               |               |
|-------------------|---------------|---------------|
| Retained Earnings | 3,310,700,000 |               |
| Cash              |               | 3,307,300,000 |
| Dividends Payable |               | 3,400,000     |

Cash Dividends are taken out of Retained Earnings when declared for a total amount of \$3,310,700,000. Of that amount, \$3,307,300,000 has already been paid, which leaves a Dividend Payable for the difference of \$3,400,000.

PART E: DURING 2007, MERCK REPURCHASED A NUMBER OF ITS OWN  
COMMON SHARES ON THE OPEN MARKET.

**i. Describe the method Merck uses to account for its treasury stock transactions.**

When Treasury Stock is purchased it is accounted for under the cost method, which states the value of the treasury stock purchased is the amount at which you purchased it.

**ii. Refer to note 11 to Merck's financial statements. How many shares did Merck repurchase on the open market during 2007?**

Merck bought a total of 2,567,899 shares on the open market during 2007. This is calculated as the difference between the number of shares held in treasury in 2007 of 811,005,791 shares less the number of shares held in treasury in 2006 808,437,892 shares.

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

On the repurchased 2,567,899 shares, Merck paid a total of \$607,300,000. This amount is calculated as the difference between the dollar value of the treasury stock using the cost method in 2007 and 2006 of \$28,174,700,000 and \$27,567,400,000 respectively. Thus, the average per share would be total amount paid of \$607,300,000 divided by the number of shares repurchased as 2,567,899 shares, which yields a result of \$236.50/share.

**iv. Why doesn't Merck disclose its treasury stock as an asset?**

Listing one's own stock as an asset is inaccurate and improper. It is merely a reduction in the Common Stock (an equity account) outstanding. It has no sustainable or reoccurring capabilities of earning income and should not be treated as an asset.

PART F: DETERMINE THE MISSING AMOUNTS AND CALCULATE THE RATIOS IN THE TABLES BELOW (TABLE 9-A & TABLE 9-B). FOR COMPARABILITY, USE DIVIDENDS PAID FOR BOTH COMPANIES RATHER THAN DIVIDENDS DECLARED. USE THE NUMBER OF SHARES OUTSTANDING AT YEAR END OF PER SHARE CALCULATIONS. WHAT DIFFERENCES DO YOU OBSERVE IN MERCK'S DIVIDEND RELATED RATIOS ACROSS THE TWO YEARS?

|                      | 2007                 | 2006              |
|----------------------|----------------------|-------------------|
| Dividends Paid       | \$ 3,307,300,000     | \$ 3,322,600,000  |
| Shares Outstanding   | 2,172,502,884 shares | \$ 2,167,785,445  |
| Net Income           | \$ 3,275,400,000     | \$ 4,433,800,000  |
| Total Assets         | \$ 48,350,700,000    | \$ 44,569,800,000 |
| Operating Cash Flows | \$ 6,999,200,000     | \$ 6,765,200,000  |
| Year End Stock Price | \$ 57.61             | \$ 41.94          |

|                                   | 2007    | 2006    |
|-----------------------------------|---------|---------|
| Dividends per share               | \$ 1.52 | \$ 1.53 |
| Dividend Yield                    | 2.64%   | 3.65%   |
| Dividend Payout                   | 1.0097  | 0.7494  |
| Dividends to Total Assets         | 0.0684  | 0.0745  |
| Dividends to Operating Cash Flows | 0.4725  | 0.4911  |

In comparison between 2007 and 2006, it became clear that not only were more dividends paid in 2006, but also these dividends represented a bigger share of the company in net income, total assets and operating cash flows than in 2007.

CASE 10: STATE STREET CORPORATION

by Charles Carey Upton III

April 4, 2018



## INTRODUCTION

This case is all about State Street Corporation. State Street Corporation is a financial holding company holding a significant amount of securities headquartered in Boston, MA. The core operations of the parent company of State Street Corporation is achieved through its subsidiary bank, State Street Bank and Trust. The primary clientele of the corporation is not individual investors, but rather institutional investors. The firm provides various and diverse services to assist, support, and manage these institutional investor's investments. As a result, this case deals equity and debt from the other side compared to other cases, such as the Merck Case. There are two different securities: equity and debt. Equity securities are investments in another firm's equity such as common stock or preferred stock. Debt Securities are investments in another firm's liabilities such as bonds they issued. Although we had already covered this topic in our Intermediate class it was great to review/brush up on the different classifications of both equity and debt securities and their proper accounting treatment.

PART A: CONSIDER TRADING SECURITIES. NOTE THAT FINANCIAL INSTITUTIONS SUCH AS STATE STREET TYPICALLY CALL THESE SECURITIES "TRADING ACCOUNT ASSETS."

**i) In general, what are trading securities?**

Securities are the investments by investors into either the debt or equity issued by another different company. There are two different types: debt and equity. However, these securities are treated different based upon management's intent. There are three different classifications: trading, available for sale, and held to

maturity. The trading securities are investments that management is planning on selling soon.

**ii) How would a company record \$1 of dividends or interest received from trading securities?**

|      |   |                              |
|------|---|------------------------------|
| Cash | 1 |                              |
|      |   | Dividend or Interest Revenue |
|      |   | 1                            |

**iii) If the market value of trading securities increased by \$1 during the reporting period, what journal entry would the company record?**

|                       |   |                                |
|-----------------------|---|--------------------------------|
| Fair Value Adjustment | 1 |                                |
|                       |   | Unrealized Holding Gain-Income |
|                       |   | 1                              |

PART B: CONSIDER SECURITIES AVAILABLE FOR SALE. NOTE THAT STATE STREET CALLS THESE, "INVESTMENT SECURITIES AVAILABLE FOR SALE."

**i) In general, what are securities available-for-sale?**

Available for sale securities are investments that a hybrid between trading and held to maturity securities. They are not intended to be held to maturity but are not actively being traded either. These investments are in a weird no-man's land.

**ii) How would a company record \$1 of dividends or interest received from securities available for sale?**

|      |   |                              |
|------|---|------------------------------|
| Cash | 1 |                              |
|      |   | Dividend or Interest Revenue |
|      |   | 1                            |

**iii) If the market value of securities available-for-sale increased by \$1 during the reporting period, what journal entry would the company record?**

|                                |   |
|--------------------------------|---|
| Fair Value Adjustment          | 1 |
| Unrealized Holding Gain-Equity | 1 |

PART C: CONSIDER SECURITIES HELD-TO-MATURITY. NOTE THAT STATE STREET CALLS THESE, “INVESTMENT SECURITIES HELD TO MATURITY.”

**i) In general, what are these securities? Why are equity securities never classified as held to maturity?**

These investments are debt securities that have management’s intent for them to be held by the owner until the debt’s maturity date. Equity securities are never classified as held to maturity, because ownership in a company has no “maturity date.” That is like saying you expect the company to stop its operations on a set date out in the future.

**ii) If the market value of securities held-to-maturity increased by \$1 during the reporting period, what journal entry would the company record?**

There is no entry for held to maturity securities for adjustments in fair value. Instead, the securities are valued at amortized cost.

PART D: CONSIDER THE “TRADING ACCOUNT ASSETS” ON STATE STREET’S  
BALANCE SHEET.

- i) What is the balance in this account on December 31, 2012? What is the market value of these securities on that date?**

The balance on the books according of the Trading Account Assets to the Consolidated Statement of Condition and the market value is \$637 million, because the securities are valued on the books at fair value.

- ii) Assume that the 2012 unadjusted trial balance for trading account assets was \$552 million. What adjusting journal entry would State Street make to adjust this account to market value? Ignore any income tax effects for this part.**

If the unadjusted balance to the trading account asset was \$552 million, then a debit of \$85 million to the trading account asset account was made in order adjust the securities to fair value. The credit would be to an unrealized holding gain-income, because the securities have not been sold yet and the unrealized gain flows through income, not other comprehensive income. It would look like this:

|                       |    |                                |
|-----------------------|----|--------------------------------|
| Trading Account Asset | 85 |                                |
|                       |    | Unrealized Holding Gain-Income |
|                       |    | 85                             |

PART E: CONSIDER THE BALANCE SHEET ACCOUNT “INVESTMENT  
SECURITIES HELD TO MATURITY” AND THE RELATED DISCLOSURES IN  
NOTE 4.

- i) What is the 2012 year-end balance in this account?**

The year-end balance according to the Consolidated Statement of Condition is \$11,379 million.

**ii) What is the market value of State Street's investment securities held to maturity?**

The market value at December 31, 2012 for the Investment Securities held to maturity is \$11,661 million.

**iii) What is the amortized cost of these securities? What does "amortized cost" represent? How does amortized cost compare to the original cost of the securities?**

The amortized cost of these securities according to Note 4 is \$11,379 million. The amortized cost is book value of the held to maturity securities. It innately includes any discount or premium associated with the bond cost of the purchase. The amortized cost is the cost remaining as the debt is being amortized to its face value.

**iv) What does the difference between the market value and the amortized cost represent? What does the difference suggest about how the average market rate of interest on held-to-maturity securities has changed since the purchase of the securities held by State Street?**

The difference between the market value and the amortized cost is the difference between what the market believes the debt security and its interest is worth and what the market at the time of purchase believed the security to be worth. The difference would suggest whether the interest rate has increased or decreased since the purchase of the debt security.

PART F: CONSIDER THE BALANCE SHEET ACCOUNT “INVESTMENT  
SECURITIES AVAILABLE FOR SALE” AND THE RELATED DISCLOSURES IN  
NOTE 4.

**i) What is the 2012 year-end balance in this account? What does this balance represent?**

The 2012 year-end balance for the Investment Securities available for sale is \$109,682 million.

**ii) What is the amount of net unrealized gains or losses on the available-for-sale securities held by State Street at December 31, 2012? Be sure to note whether the amount is a net gain or loss.**

There is a net unrealized gain of \$1,119 million for the available for sale securities.

**iii) What was the amount of net realized gains (losses) from sales of available-for-sale securities for 2012? How would this amount impact State Street’s statements of income and cash flows for 2012?**

There is a net realized gain \$55 million from the sales of these securities. Because of State Street’s nature as a financial services firm, the core operations of the business are making sales of these investments. Thus, what would normally be a non-operating activity is an operating gain for State Street.

PART G: STATE STREET'S STATEMENT OF CASH FLOW FOR 2012 (NOT INCLUDED) SHOWS THE FOLLOWING LINE ITEMS IN THE "INVESTING ACTIVITIES" SECTION RELATING TO AVAILABLE-FOR-SALE SECURITIES (IN MILLIONS): PROCEEDS FROM SALES OF AVAILABLE-FOR-SALE SECURITIES \$5,399 AND PURCHASES OF AVAILABLE-FOR-SALE SECURITIES \$60,812.

**i) Show the journal entry State Street made to record the purchase of available-for-sale securities for 2012.**

|   |        |        |
|---|--------|--------|
| Investment in Available for Sale Securities | 60,812 |        |
| Cash  |        | 60,812 |

**ii) Show the journal entry State Street made to record the sale of available-for-sale securities for 2012. Note 13 (not included) reports that the available-for-sale securities sold during 2012 had "unrealized pre-tax gains of \$67 million as of December 31, 2011."**

|                                |       |       |
|--------------------------------|-------|-------|
| Cash                           | 5,399 |       |
| Unrealized Holding Loss-Equity | 67    |       |
| Available for Sale Securities  |       | 5,471 |
| Realized Gain on AFS           |       | 55    |

**iii) Use the information in part g. ii to determine the original cost of the available-for-sale securities sold during 2012.**

The original cost of the available for sale securities would be the book value less the realized gain. Thus,  $5,471 - 55 = 5,416$ .

CASE 11: ZAGG, INC.

by Charles Carey Upton III

April 11, 2018



## INTRODUCTION

This case is all about “Zealous About Great Gadgets” or better known as ZAGG, Inc. What began as a niche market of wristwatch protection shields in 2005 quickly expanded to encompass all mobile device accessories. With its leading innovation of the “invisibleSHIELD” and recent acquisition of iFrogz, ZAGG has turned into a market leader. It is a publicly traded company on the NASDAQ and deals with the IRS (as does every business) with tax implications. One of the key issues on ZAGG’s books is the presence of deferred tax assets and liabilities. Although we had already covered this topic in our Intermediate class it was great to review and go in more depth with the purpose of the deferred tax asset account and see the FASB Codification’s take on the matter.

**PART A: DESCRIBE WHAT IS MEANT BY THE TERM BOOK INCOME? WHICH NUMBER IN ZAGG’S STATEMENT OF OPERATION CAPTURES THIS NOTION FOR FISCAL 2012? DESCRIBE HOW A COMPANY’S BOOK INCOME DIFFERS FROM ITS TAXABLE INCOME.**

Book Income is also known as the pre-tax income, which is the income before income taxes are subtracted according to GAAP (the Generally Accepted Accounting Principles). In ZAGG’s Statement of Operations, the book income is titled the “Income before provision for income taxes.” Pre-tax financial income and taxable income differ, because they are based off two different sets of rules, GAAP and IRS Code. Generally, the IRS code forces income to be reported on a cash basis, while GAAP requires an accrual basis. These different bases for accounting income results in different income numbers.

PART B: IN YOUR OWN WORDS DESCRIBE THE FOLLOWING TERMS:

**i. Permanent tax differences (also provide an example)**

Permanent tax differences are variances between pre-tax financial income and taxable income that will never reverse out, because of the nature of the difference. An example is a municipal bond. A municipal bond is a bond that pays interest, but the interest is tax deductible. As a result, the owner will never pay on the interest revenue earned from the municipal bond, while it will recognize it under GAAP guidelines.

**ii. Temporary tax difference (also provide an example)**

Temporary tax differences are variances between pre-tax financial income and taxable income that will reverse out over time. In other words, it is only a timing difference between when it is recognized as income for GAAP and IRS. An example of this would be cash received in advance for a service to be provided. Under GAAP, the cash would be debited, and a liability of Unearned Revenue would be created by crediting it. In other words, it would not be considered revenue till the performance obligation was satisfied. On the other hand, the IRS considers income to be cash received. Thus, the cash received in advance would be considered income and would be taxable in the current period and become a future deductible amount.

**iii. Statutory tax rate**

The Statutory tax rate is the tax rate defined by law on the business' income. This value is rarely, if ever paid by businesses for two reasons: deferred tax accounts and tax avoidance through off-shoring income.

**iv. Effective tax rate**

The Effective tax rate is the tax rate that is truly paid by the business. It is computed as the taxes payable divided by pre-tax financial income.

PART C: EXPLAIN IN GENERAL TERMS WHY A COMPANY REPORTS DEFERRED INCOME TAXES AS PART OF THEIR TOTAL INCOME TAX EXPENSE. WHY DON'T COMPANIES SIMPLY REPORT THEIR CURRENT TAX BILL AS THEIR INCOME TAX EXPENSE?

Simply, the deferred income tax accounts of assets and liabilities have an impact on the income tax expense that are not reflected in the amount that the company is currently paying the IRS. The amount that is paid to the IRS currently is calculating by taking taxable income and multiplying it by the statutory rate. This is the amount is known as income taxes payable and is the current portion of the income tax expense. However, the tax expense amount considers differences between pre-tax financial income and taxable income resulting from variances between GAAP and IRS code. Some of these differences are permanent and will never be reversed and are subsequently not recognized in income tax expense. The temporary differences however, are reversible and are recognized in the income tax expense and payable journal entry depending upon the nature of the deferred amount.

Future deductible amounts from income tax, which are also known as deferred tax assets, cause income tax expense for the current year to decrease. While future taxable amounts, which are also known as deferred tax liabilities, cause income tax expense for the current year to increase. The reason for this impact is the journal entry made to record the

differences between income taxes payable, which is the amount paid to the IRS, and the income tax expense, which is the amount of income tax recognized by GAAP. This journal entry debits income tax expense and any deferred tax assets present. As a result, the deferred tax asset increases the income taxes payable, because it increases the amount to be paid in the current period by having a future deductible amount to be subtracted from the income tax expense in the future. On the other side of the entry, income taxes payable and any deferred tax liabilities are credited. Hence, the presence of a deferred tax liability decreases income taxes payable, because it decreases the amount to be paid in the current period by having a future taxable amount to be added to income tax expense in the future.

PART D: EXPLAIN WHAT DEFERRED INCOME TAX ASSETS AND DEFERRED INCOME TAX LIABILITIES REPRESENT. GIVE AN EXAMPLE OF A SITUATION THAT WOULD GIVE RISE TO EACH OF THESE ITEMS ON THE BALANCE SHEET.

Deferred income tax assets are the taxes saved in future years, which is equal to a currently payable amount. An example of a situation that would cause a deferred income tax asset would be an excess of tax depreciation over book depreciation. This difference in depreciation is saying that there was more depreciation expense applied to the taxable income than the pre-tax financial income. As a result, the taxable income is lower than the pre-tax financial income and this inequality yields a future taxable (currently deductible) amount. On the other hand, the deferred income tax liabilities are taxes to be paid in the future, which is synonymous with a currently deductible amount. An example of a situation that would cause a deferred income tax liability is the deferral for book purposes of rent received in advance. The advanced cash would be recognized as income under IRS code,

but not under GAAP, which would result in taxable income being greater than pre-tax financial income. This result would cause a future deductible (currently taxable) amount.

PART E: EXPLAIN WHAT A DEFERRED INCOME TAX VALUATION  
ALLOWANCE IS AND WHEN IT SHOULD BE RECORDED.

A deferred income tax allowance is the valuation account for the deferred tax asset. As most might recall from above, a deferred tax asset is a future deductible amount, but a currently payable amount. Thus, one must have income to deduct the tax savings from. This allowance is the account which future deductible amount is deducted from. The allowance account is a contra-deferred tax asset account and is used when the future deductible amount reverses and is taken out of tax expense. An inquisitive one might ask why deferred tax liabilities have their own valuation account. A deferred tax liability results in a future taxable amount. A company does not have to income to pay taxes on an item that occurred in previous periods.

PART F: CONSIDER THE INFORMATION DISCLOSED IN NOTE 8 – INCOME  
TAXES TO ANSWER THE FOLLOWING QUESTIONS:

- i. Using information in the first table in Note 8, show the journal entry that ZAGG recorded for the income tax provision in fiscal 2012?**

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

**ii. Using the information in the third table in Note 8, decompose the amount of “net deferred income taxes” recorded in income tax journal entry in part f. i. into its deferred income tax asset and deferred income tax liability components.**

Net Deferred Income Taxes are composed of 14,302 of deferred tax assets and 794 deferred tax liabilities, which nets to a 13,508 deferred tax asset at the end of 2012.

**iii. The second table in Note 8 provides a reconciliation of income taxes computed using the federal statutory rate (35%) to income taxes computed using ZAGG’s effective tax rate. Calculate ZAGG’s 2012 effective tax rate using the information provided in their income statement. What accounts for the difference between the statutory rate and ZAGG’s effective tax rate?**

Effective Tax Rate = Income Taxes Payable / Pre-tax financial income

Effective Tax Rate = 9,393 / 23,898

Effective Tax Rate = 39.30%

**iv. According to the third table in Note 8 – Income Taxes, ZAGG had a net deferred income tax asset balance of \$13,508,000 at December 31, 2012. Explain where this amount appears on ZAGG’s balance sheet.**

The 13,508 of the deferred tax asset is split into current and non-current portions of 6,912 and 6,596, respectively on the balance sheet.

CASE 12: APPLE

by Charles Carey Upton III

May 2, 2018

## INTRODUCTION

This case is all about Apple Inc. Apple is one of the biggest names in the modern culture both as a business and throughout popular culture. Apple has singlehandedly revolutionized the music, phone, computer, and now watch industries. Through cutting edge designs and manufacturing processes Apple can sell a variety of products all of which are in high demand. Because of the large demand, the company sells its products in not only physical retail stores, but online stores, direct sales force, third-party wholesalers, resellers, and value-added resellers. By having a such a large and diverse range of sales, it raises the question of which of these are core parts of the business operation. The amount recognized as a revenue or gain depends largely upon this determination, because that is the main criteria on how it is classified. in the whether they were earned through. Revenue recognition is the main learning objective of this case. It is an extremely relevant and important in today's economy and financial system. Our Intermediate book even states that "revenue is one of, if not the most, important measures of financial performance that a company report." Recently FASB has passed new revenue recognition standards, which will be dealt with later in the case. Although we had already covered this topic in our Intermediate class, it was great to review and go in more depth with a real-world company that is tasked with putting the new standard into practice.

### PART A: IN YOUR OWN WORDS, DEFINE "REVENUES." EXPLAIN HOW REVENUES ARE DIFFERENT FROM "GAINS."

Revenues are the amount of money received for work completed, products sold, or services provided by the core operations of the business entity. On the other hand, gains



are the amount of money received for work completed, products sold, or services provided by the non-core operations of the business entity. Thus, the main determination to be made by accountants is what the core business of the business entity is.

PART B: DESCRIBE WHAT IT MEANS FOR A BUSINESS TO “RECOGNIZE” REVENUES. WHAT SPECIFIC ACCOUNTS AND FINANCIAL STATEMENTS ARE AFFECTED BY THE PROCESS OF REVENUE RECOGNITION? DESCRIBE THE REVENUE RECOGNITION CRITERIA OUTLINE IN THE FASB’S STATEMENT OF CONCEPTS NO. 5.

According to FASB Concept Statement #5, “recognition is the process of formally incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals.” Prior to the new revenue recognition principle, recognizing revenue was a quite difficult. However, the new standard, ASC 606, gives much more in depth guidance on how to “recognize” revenues. This standard requires recognizing revenue using an asset-liability approach as the basis. In other words, revenue is recognized based on changes in assets and liabilities. There is a 5-step process for determining the revenue recognition through this basis: identifying the contract, identifying the performance obligation(s), determining transaction price, allocating the transaction price to the separate performance obligations, and recognizing the revenue upon the completion of each obligation.

PART C: REFER TO THE REVENUE RECOGNITION DISCUSSION IN NOTE 1. IN GENERAL, WHEN DOES APPLE RECOGNIZE REVENUE? EXPLAIN APPLE'S FOUR REVENUE RECOGNITION CRITERIA. DO THEY APPEAR TO BE ALIGNED WITH THE REVENUE RECOGNITION CRITERIA YOU DESCRIBED IN PART B, ABOVE?

Generally, Apple recognizes revenue “when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable.” Apple is saying that these four criteria must be present for the company to recognize in revenue. First, there must be a contract in place. In other words, a sale has taken place that both parties have agreed to. Secondly, the product has been delivered to the buyer, which satisfies the performance obligation established by the contract. Thirdly, the amount of money made from the sale is either fixed or easily determinable. In other words, how much did they sell it for. Lastly, the collection of that money from the sale is likely to be collected. These four steps align well with the revenue recognition principle outlined in part b.

PART D: WHAT ARE MULTIPLE-ELEMENT CONTRACTS AND WHY DO THEY POSE REVENUE RECOGNITION PROBLEMS FOR COMPANIES?

Multiple element contracts are agreements or contracts between two parties that have multiple performance obligations. This makes it difficult for the accountants and companies to determine the amount of revenue to be recognized, if any, upon the completion of one of the multiple performance obligations.

PART E: IN GENERAL, WHAT INCENTIVES DO MANAGERS HAVE TO MAKE  
SELF SERVING REVENUE RECOGNITION CHOICES?

Many managers are given bonuses or incentives based off the performance of their sector of the business. Often when there is a gray area, managers tend to lean towards recognizing more revenue, because it helps them out. As it says in the prompt it is quite self-serving and can hurt the company in the long run.

PART F: REFER TO APPLE'S REVENUE RECOGNITION FOOTNOTE. IN  
PARTICULAR, WHEN DOES THE COMPANY RECOGNIZE REVENUE FOR THE  
FOLLOWING TYPES OF SALES?

**i. iTunes songs sold online.**

According to Note 1, Apple recognizes revenue of “third-party digital content sold on the iTunes Store in accordance with general revenue recognition accounting guidance.” Thus, as ASC 606 states, once the song has been purchased and delivered, the price of the song is recognized as revenue if the buyer is probable to pay the company. The performance obligation of delivering the song to the customer has already been satisfied.

**ii. Mac-branded accessories such as headphones, power adaptors, and backpacks sold in the Apple stores. What if the accessories are sold online?**

According to Note 1, Apple recognizes revenue on “the sale of hardware products (e.g., Macs, iPhones, iPads, iPods and peripherals)... with general revenue recognition accounting guidance.” Thus, as ASC 606 states, once the physical product has been purchased in the store and given to the customer, the price of the

product is recognized as revenue so long as the buyer is probable to pay the company. The performance obligation of delivering the product to the customer has already been satisfied. However, the product was purchased on the online store, the company would have to wait till the product was physically delivered to the customer to recognize the revenue, because the performance obligation of delivering the product had not yet been completed.

**iii. iPods sold to a third-party reseller in India.**

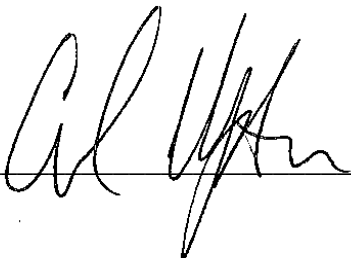
According to Note 1, Apple recognizes and allocates revenue of physical hardware sold to third party reseller according to the “relative sales price method.” The company states that it has identified two performance obligations in the scenario described above. “The first deliverable is the hardware and software essential to the functionality of the hardware device delivered at the time of sale. The second deliverable is the embedded right included with the purchase of iPhone, iPad, iPod touch and Apple TV to receive on a when-and-if-available basis, future unspecified software upgrades and features relating to the product’s essential software. Thus, as ASC 606 states, the revenue cannot be recognized till the performance obligation(s) are satisfied.

**iv. Revenue from gift cards**

According to Note 1, upon the sale of gift cards, Apple “records deferred revenue upon the sale of the card, which is relieved upon redemption of the card by the customer.” Thus, as ASC 606 states, the revenue cannot be recognized till the performance obligation of delivering the product purchased by gift card is satisfied.

## HONOR CODE AND SIGNATURE

ON MY HONOR, I PLEDGE THAT I HAVE NEITHER GIVEN, RECEIVED, NOR  
WITNESSED ANY UNAUTHORIZED HELP ON THESE CASES.



A handwritten signature in black ink, appearing to read "Al [unclear]", is written over a horizontal line.