A CASE STUDY IN THE PRINCIPLES AND PRACTICE OF ACCOUNTING

by

Ryan Maddigan

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Oxford

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Approved by

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Advisor: Professor Victoria Dickinson

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ABSTRACT

RYAN MADDIGAN: A Case Study in the Principles and Practice of Accounting

(Under the direction of Victoria Dickinson)

The research for this thesis project is intended to be a comprehensive study on the various concepts present in the principles and practice of accounting. This includes financial analyses and other examinations of financial information for a variety of different situations and companies using several different measures and concepts. The goal of these case studies is to determine accounting best practices based on GAAP for each company and their effect on the company's financial statements and reporting. This was determined specifically through analysis by comparison of accounting ratios on profitability, liquidity, turnover, financial leverage and dividend policy as well as examination and application of the accounting standards found in the FASB Accounting Standards Codification. Topics include the effects of accounting estimates, income statement/balance sheet/statement of cash flows presentation, accounting for bad debts, accounting for inventory impairments as well as accounting for leases, among others. In addition to the analyses on financial reporting, included is an analysis of a case regarding internal control procedures and their implementation. I found that the situations presented by the cases were an excellent summation of the knowledge I have acquired over the course of my accounting studies and that the cases both furthered that knowledge and provided a way of applying that knowledge. But overall, I determined that accounting knowledge and research can be applied in number of ways and that using a variety of different methods and tools to analyze transactions and financial data provides the most thorough and accurate results.

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Case 1

Financial Analysis of Glenwood Heating, Inc. and Eads Heaters, Inc.

By Ryan Maddigan

Executive Summary:

In this case one will find the charts of accounts, financial statements, and profitability ratios that serve to compare the financial success and potential for investment or lending for the two heater companies, Glenwood Heating, Inc. and Eads Heater, Inc. After analysis of their transactions and financial statements, it is clear that Glenwood Heating is the superior investing and/or lending partner, as it seems to be significantly more profitable in comparison to Eads.

Table 1-2
Home Heaters
Part A: Recording Basic Transactions

	Assets						=	Liabilities			+	Stockholders' Equity	
	Cash	Accounts Receivable	Inventory	Land	Building	Equipment		Accounts Payable	Notes Payable	Interest Payable		Common Stock	Retained Earnings
No. 1	160,000								400,000			160,000	
No. 2	400,000												
No. 3	{420,000}			70,000	350,000								
No. 4	{80,000}					80,000							
No. 5			239,800					239,800					
No. 6		398,500											398,500
No. 7	299,100	{299,100}											
No. 8	{213,360}							{213,360}					
No. 9	{41,000}								{20,000}				{21,000}
No. 10	{34,200}												{34,200}
No. 11	{23,200}												{23,200}
No. 12										6,650			{6,650}
Balance	$47,340	$99,400	$239,800	$70,000	$350,000	$80,000		$26,440	$380,000	$6,650		$160,000	$313,450

Table 1-2
Glenwood Heating Inc.
Part B: Recording Additional Information

	Assets								
Transaction	Cash	Accounts Receivable	Allowance For Bad Debts	Inventory	Land	Building	Accumulated Depreciation Building	Equipment	Accumulated Depreciation Equipment
Balances: Part A	47,340	99,400		239,800	70,000	350,000		80,000	
Part B (1): Bad Debts			{994}						
Part B (2): COGS				{177,000}					
Part B (3): Depreciation									
Building							{10,000}		
Equipment									{9,000}
Part B (4): Equipment									
Rental Payment	{16,000}								
Part B (5): Income Tax	{30,914}								
Balances	$426	$99,400	${994}	$62,800	$70,000	$350,000	${10,000}	$80,000	${9,000}

	Liabilities			Owners' Equity	
Transaction	Accounts Payable	Notes Payable	Interest Payable	Common Stock	Retained Earnings
Balances: Part A	26,480	380,000	6,650	160,000	313,450
Part B (1): Bad Debts					{994}
Part B (2): COGS					{177,000}
Part B (3): Depreciation					
Building					{10,000}
Equipment					{9,000}
Part B (4): Equipment					
Rental Payment					{16,000}
Part B (5): Income Tax					{30,914}
Balances	$26,440	$380,000	$6,650	$160,000	$69,542

Table 1-3
Glenwood Heating, Inc.
Income Statement
For Year Ended December 31, 20X1

Sales Revenue	398,500
Cost of Goods Sold	{177,000}
Gross Profit	221,500
Bad Debt Expense	{994}
Depreciation Expense	{19,000}
Rent Expense	{16,000}
Other Operating Expenses	{34,200}
Income From Operations	151,306
Interest Expense	{27,650}
Income From Continuing Operations (Before Tax)	123,656
Income Tax	{30,914}
Net Income	$92,742

Table 1-4

Glenwood Heating, Inc.

Statement of Retained Earnings

For Year Ended December 31, 20X1

	Total	Retained Earnings	Common Stock
Beginning Balance	160,000	0	160,000
Net Income	92,742	69,542	0
Ending Balance	$252,742	$69,542	$160,000

Table 1-5
Glenwood Heating, Inc.
Classified Balance Sheet
For Year Ended December 31, 20X1

Assets		
Current Assets		
Cash	426	
Accounts Receivable	99,400	
Less: Allowance For Bad Debts	{994)	
Inventory	62,800	
Total Current Assets		161,632
Property, Plant, and Equipment		
Land	70,000	
Building	350,000	
Less: Accumulated Depreciation	{10,000}	
Equipment	80,000	
Less: Accumulated Depreciation	{9,000}	
Total Property, Plant, and Equipment		481,000
Total Assets		$642,632

Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	26,440	
Interest on Note Payable	6,650	
Total Current Liabilities		33,090
Long Term Liabilities		
Notes Payable	380,000	
Total Long Term Liabilities		380,000
Total Liabilities		413,090
Stockholders' Equity		
Common Stock	160,000	
Retained Earnings	69,542	
Total Stockholders' Equity		229,542
Total Liabilities and Stockholders' Equity		$642,632

Table 1-6
Glenwood Heating, Inc.
Statement of Cash Flows
For Year Ended December 31, 20X1

Cash Flows from Operating Activities		
Net Income		92,742
Adjustments:		
Depreciation Expense	19,000	
Bad Debt Expense	994	
Accounts Receivable	{99,400}	
Inventory	{62,800}	
Accounts Payable	26,440	
Interest Payable	6,650	
Net Cash Flows From Operating Activities		{16,374}
Cash Flows From Investing Activities		
Land Purchase	{70,000}	
Building Purchase	{350,000}	
Equipment Purchase	{80,000}	
Net Cash Flows From Investing Activities		{500,000}
Cash Flows From Investing Activities		
Proceeds From Borrowing on Note Payable	380,000	
Proceeds From Issuance of Common Stock	160,000	
Payment of Cash Dividend	{23,200}	
Net Cash Flows From Financing Activities		516,800
Total Net Cash Flows		$426

Table 1-7
Eads Heater Inc.
Part B: Recording
Additional Information

	Assets						
Transaction	Cash	Accounts Receivable	Allowance For Bad Debts	Inventory	Land	Building	Accumulated Depreciation Building
Balances: Part A	47,340	99,400		239,800	70,000	350,000	
Part B (1): Bad Debts			{4,970}				
Part B (2): COGS				{188,800}			
Part B (3): Depreciation							
Building							{10,000}
Equipment							
Part B (4): Equipment							
Lease							
Lease Payment	{16,000}						
Depreciation							
Part B (5): Income Tax	{23,505}						
Balances	$7,835	$99,400	${4,970}	$51,000	$70,000	$350,000	${10,000}

Table 1-7
Continued

	Assets				Liabilities				Owners' Equity	
Transaction	Equipment	Accumulated Depreciation Equipment	Leased Equipment	Accumulated Depreciation Lease	Accounts Payable	Notes Payable	Interest Payable	Lease Payable	Common Stock	Retained Earnings
Balances: Part A	80,000				26,440	380,000	6,650		160,000	313,450
Part B (1): Bad Debts										{4,970}
Part B (2): COGS										{188,800}
Part B (3): Depreciation										
Building										{10,000}
Equipment		{20,000}								{20,000}
Part B (4): Equipment										
Lease			92,000					92,000		
Lease Payment								{8,640}		{7,360}
Depreciation				{11,500}						{11,500}
Part B (5): Income Tax										{23,505}
Balances	$80,000	${20,000}	$92,000	${11,500}	$26,440	$380,000	$6,650	$83,360	$160,000	$47,315

Table 1-8
Eads Heater, Inc.

Income Statement

For Year Ended December 31, 20X1

Sales Revenue	398,500
Cost of Goods Sold	{188,800}
Gross Profit	209,700
Bad Debt Expense	{4,970}
Depreciation Expense	{41,500}
Other Operating Expenses	{34,200}
Income From Operations	129,030
Interest Expense	{35,010}
Income From Continuing Operations (Before Tax)	94,020
Income Tax	{23,505}
Net Income	$70,515

Table 1-9
Eads Heater, Inc.

Statement of Retained Earnings

For Year Ended December 31, 20X1

	Total	Retained Earnings	Common Stock
Beginning Balance	160,000	0	160,000
Net Income	70,515	47,315	0
Ending Balance	$230,515	$47,315	$160,000

Table 1-10
Eads Heater, Inc.
Classified Balance Sheet
For Year Ended December 31, 20X1

Assets

Current Assets		
Cash	7,835	
Accounts Receivable	99,400	
Less: Allowance For Bad Debts	{4,970}	
Inventory	51,000	
Total Current Assets		153,265
Property, Plant, and Equipment		
Land	70,000	
Building	350,000	
Less: Accumulated Depreciation	{10,000}	
Equipment	80,000	
Less: Accumulated Depreciation	{20,000}	
Leased Equipment	92,000	
Less: Accumulated Depreciation	{11,500}	
Total Property, Plant, and Equipment		550,500
Total Assets		$703,765

Liabilities and Stockholders' Equity

Table 1-10 Continued

Current Liabilities		
Accounts Payable	26,440	
Interest on Note Payable	6,650	
Total Current Liabilities		33,090
Long Term Liabilities		
Notes Payable	380,000	
Lease Payable	83,360	
Total Long Term Liabilities		463,360
Total Liabilities		496,450
Stockholders' Equity		
Common Stock	160,000	
Retained Earnings	47,315	
Total Stockholders' Equity		207,315
Total Liabilities and Stockholders' Equity		$703,765

Table 1-11
Eads Heaters, Inc.
Statement of Cash Flows
For Year Ended December 31, 20X1

Cash Flows from Operating Activities		
Net Income		70,515
Adjustments:		
Depreciation Expense	41,500	
Bad Debt Expense	4,970	
Accounts Receivable	{99,400}	
Inventory	{51,000}	
Accounts Payable	26,440	
Interest Payable	6,650	
Net Cash Flows From Operating Activities		{325}
Cash Flows From Investing Activities		
Land Purchase	{70,000}	
Building Purchase	{350,000}	
Equipment Purchase	{80,000}	
Net Cash Flows From Investing Activities		{500,000}
Cash Flows From Investing Activities		
Proceeds From Borrowing on Note Payable	380,000	
Proceeds From Issuance of Common Stock	160,000	
Payment of Cash Dividend	{23,200}	
Payment on Principle of Lease	{8,640}	
Net Cash Flows From Financing Activities		508,160
Total Net Cash Flows		$7,835

Glenwood Heating, Inc. Profitability Ratios

Gross Profit Margin:	55.58%		
Profit Margin:	23.27%	Debt Ratio:	64.28%
Return on Assets:	14.43%	Times Interest Earned:	5.47
Return on Equity:	57.96%		

Eads Heater, Inc. Profitability Ratios

Gross Profit Margin:	52.62%		
Profit Margin:	17.70%	Debt Ratio:	70.54%
Return on Assets:	10.02%	Times Interest Earned:	3.69
Return on Equity:	44.07%		

Conclusion:

It appears that Glenwood Heating is in better financial shape than Eads Heater. Although Eads has a higher cash flow for both operating activities and in total, Glenwood in almost every other aspect is more profitable on an operational level. This is evident in the fact that it has more net income and retained earnings than its competitor but also seems to be performing better in profitability ratio tests. Its profit margin and gross profit margin are both higher than Eads while also it seems to be more efficient with its assets

as well as its shareholders' equity, providing a superior return. Overall it seems to be in a more sound financial position, as its debt ratio is lower than Eads Heater and can pay off its interest 5.47 times over compared with 3.69 times interest earned from Eads. For these reasons I would recommend investing in or lending money to Glenwood Heating, Inc. rather than Eads.

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Appendix

Glenwood Profitability Ratios (Calculations)

1. Gross Pofit Margin: (Revenue - COGS)/ Revenue	(398,500 – 177,000)/ 398,500 = 55.58%
2. Profit Margin: Net Income/ Net Sales	92,742/398,500 = 23.27%
3. Return on Assets: Net Income/ Average total assets	92,742/642,632 = 14.43%
4. Return on Equity: Net Income/ Shareholders' Equity	92,742/160,000 = 57.96%
5. Debt Ratio: Total liabilities/ Total assets	413,090/642,632 = 64.28%
6. Times Interest Earned: Income before interest and taxes/ Interest expense	151,306/27,650 = 5.47

Eads Profitability Ratios (Calculations)

1. Gross Pofit Margin: (Revenue - COGS)/ Revenue	(398,500 – 188,800)/ 398,500 = 52.62%
2. Profit Margin: Net Income/ Net Sales	70,515/398,500 = 17.70%
3. Return on Assets: Net Income/ Average total assets	70,515/703,765 = 10.02%
4. Return on Equity: Net Income/ Shareholders' Equity	70,515/160,000 = 44.07%
5. Debt Ratio: Total liabilities/ Total assets	496,450/703,765 = 70.54%
6. Times Interest Earned: Income before interest and taxes/ Interest expense	129,030/35,010 = 3.69

Case 2

Totz: Guidance on Appropriate Income Statement Presentation

By Ryan Maddigan

1.

Regulation S-X Rule 5-03, Income Statements (Codification 225-10-S99-2)

- “(b) If income is derived from more than one of the subcaptions described under § 210.5–03.1, each class which is not more than 10 percent of the sum of the items may be combined with another class. If these items are combined, related costs and expenses as described under § 210.5–03.2 shall be combined in the same manner.”
- 1. Net sales and gross revenues. State separately:
    - (a) Net sales of tangible products (gross sales less discounts, returns and allowances),
    - (b) operating revenues of public utilities or others;
    - (c) income from rentals;
    - (d) revenues from services; and
    - (e) other revenues.”

According to Regulation S-X Rule 5-03, one should state net sales of tangible products, with revenues from services to be stated separately from those net sales on the income statement because each category is more than ten percent of the sum of the items.

2.

Costs and Expenses (Codification 270-10-45-4)

- “Costs and expenses for interim reporting purposes may be classified as either of the following:
    - Costs associated with revenue - those costs that are associated directly with or allocated to the products sold or to the services rendered and that are charged against income in those interim periods in which the related revenue is recognized.”

Regulation S-X Rule 5-03, Income Statements (Codification 225-10-S99-2)

- “2. Costs and expenses applicable to sales and revenues.

State separately the amount of

- (a) cost of tangible goods sold,
- (b) operating expenses of public utilities or others,
- (c) expenses applicable to rental income,
- (d) cost of services, and
- (e) expenses applicable to other revenues.”

SAB Topic 11.B, Depreciation and Depletion Excluded from Cost of Sales (Codification 225-10-S99-8)

- “Facts: Company B excludes depreciation and depletion from cost of sales in its income statement.
- Question: How should this exclusion be disclosed?
- Interpretive Response: If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below)." To avoid placing undue emphasis on "cash flow," depreciation, depletion and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation.”

According to Codification 270-10-45-4, costs and expenses directly associated with products sold or to the services rendered would be classified under costs associated with revenue. Being that costs such as product costs, freight-in, import costs, and direct labor costs are all directly associated with the products sold/services rendered and fall under the categories of either tangible goods or cost of services, they should be stated separately on the income statement in accordance with the second section of Regulation S-X Rule 5-03. Also, with regard to depreciation being excluded from

cost of sales in the income statement, SAB Topic 11.B instructs an accountant to make note of its exclusion in the line item.

3.

Accounting Standards Update No. 2015-01—Income Statement—Extraordinary and Unusual Items (Subtopic 225-20)

"The objective of this Update is to simplify the income statement presentation requirements in Subtopic 225-20 by eliminating the concept of extraordinary items. Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. Eliminating the extraordinary classification simplifies income statement presentation by altogether removing the concept of extraordinary items from consideration."

Presentation of Unusual or Infrequently Occurring Items (Codification 225-20-45-16)

"A material event or transaction that is unusual in nature or occurs infrequently but not both, and therefore does not meet both criteria for classification as an extraordinary item, shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be disclosed on the face of the income statement or, alternatively, in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes or

in any other manner that may imply that they are extraordinary items. Similarly, the EPS effects of those items shall not be presented on the face of the income statement."

Criteria for Presentation as Extraordinary Items (Codification 225-20-45-1 and 2)

"Judgment is required to segregate in the income statement the effects of events or transactions that are extraordinary items (as required by paragraphs 225-20-45-10 through 45-11). An event or transaction shall be presumed to be an ordinary and usual activity of the reporting entity, the effects of which shall be included in income from operations, unless the evidence clearly supports its classification as an extraordinary item as defined in this Subtopic.

- a. Unusual nature: The underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates.

- b. Infrequency of occurrence: The underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates."

According to Codification 225-20-45-16, "a material event or transaction that is unusual in nature or occurs infrequently but not both…" is an unusual event, while extraordinary events, which were considered both unusual and infrequent, were eliminated from consideration in Accounting Standards Update No. 2015-01. Since the

sale of company headquarters could be reasonably considered infrequent, one of the two requirements outlined in Codification 225-20-45-2 are met, which is enough to consider it an unusual event. The transaction should then be classified as such. Therefore the $1.7 million gain on sale of building should be reported as a separate component under operating income and the nature of the transaction described either on the face of in the transaction or in the notes.

4.

Presentation of Unusual or Infrequently Occurring Items (Codification 225-20-45-16)

"A material event or transaction that is unusual in nature or occurs infrequently but not both, and therefore does not meet both criteria for classification as an extraordinary item, shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be disclosed on the face of the income statement or, alternatively, in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes or in any other manner that may imply that they are extraordinary items. Similarly, the EPS effects of those items shall not be presented on the face of the income statement."

Regulation S-X Rule 5-03, Income Statements (Codification 225-10-S99-2)

- “7. Non-operating income. State separately in the income statement or in a note thereto amounts earned from
  - (a) dividends,
  - (b) interest on securities,
  - (c) profits on securities (net of losses), and
  - (d) miscellaneous other income.
- Amounts earned from transactions in securities of related parties shall be disclosed as required under § 210.4–08(k). Material amounts included under miscellaneous other income shall be separately stated in the income statement or in a note thereto, indicating clearly the nature of the transactions out of which the items arose.”

According to Accounting Standards Update No. 2015-01, extraordinary items are eliminated. So since it is not classified as extraordinary, it should simply be classified as unusual. And according to the previously cited Codification 225-20-45-16, it shall be reported as a separate component of income from continuing operations under non-operating income. In this case it would most likely fall under “miscellaneous other income” as noted in Regulation S-X Rule 5-03 and the details of the $2.7 million gain from the class action lawsuit should either be stated separately or in the footnotes.

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 3

Rocky Mountain Chocolate Factory

By Ryan Maddigan

Rocky Mountain Chocolate Factory, Inc. Journal Entries For Fiscal Year 2010			
1. Inventories		7,500,000	
	Accounts Payable		7,500,000
2. Inventories		6,000,000	
	Accrued Salaries and Wages		6,000,000
3. Cash and Cash Equivalents		17,000,000	
Accounts Receivable		5,000,000	
	Sales		22,000,000
Cost of Sales		14,000,000	
	Inventories		14,000,000
4. Accounts Payable		8,200,000	
	Cash and Cash Equivalents		8,200,000
5. Cash and Cash Equivalents		4,100,000	
	Accounts Receivable		4,100,000
6. Sales and Marketing Expenses		1,505,431	
General and Admin Expenses		2,044,569	
Retail Operating Expenses		1,750,000	
	Cash and Cash Equivalents		2,000,000
	Other Accrued Expenses		3,300,000
7. Accrued Salaries and Wages		6,423,789	
	Cash and Cash Equivalents		6,423,789
8. Cash and Cash Equivalents		125,000	
	Deferred Income		125,000
9. Property and Equipment, Net		498,832	
	Cash and Cash Equivalents		498,832
10. Retained Earnings		2,407,167	
	Cash and Cash Equivalents		2,403,458
	Dividends Payable		3,709

Journal Entries, Continued			
11. Cash and Cash Equivalents		790,224	
Notes Receivable, Current		91,059	
Deferred Income Taxes		92,052	
Property and Equipment, Net		132,859	
Notes Receivable, Less Current		139,198	
Other Accrued Expenses		2,885,413	
Dividend Payable		1	
Deferred Income		46,062	
Cost of Sales		693,786	
Franchise Costs		1,499,477	
Income Tax Expense		2,090,468	
	Accounts Receivable		702,207
	Inventories		66,328
	Other Current Assets		4,215
	Intangible Assets, Net		73,110
	Other Long Term Assets		3,007
	Accounts Payable		503,189
	Deferred Income Taxes		66,729
	Common Stock		1,112
	Additional Paid-In-Capital		315,322
	Sales		944,017
	Franchise and Royalty Fees		5,492,531
	General and Administrative		261,622
	Income Tax Expense		27,210
12. Cost of Sales		216,836	
	Inventories		216,836
13. Depreciation and Amortization Expense		698,580	
	Property and Equipment, Net		698,580
14. General and Administrative Expense		639,200	
Retail Operating Expense		6,956	
	Accrued Salaries and Wages		646,156
15. No Entry			
16. Sales		22,944,017	
Franchise and Royalty Fees		5,492,531	
Interest Income		27,210	
	Cost of Sales		14,910,622
	Franchise Costs		1,499,477
	Sales & Marketing		1,505,431
	General and Administrative		2,422,147
	Retail Operating		1,756,956
	Depreciation and Amortization		698,580
	Income Tax Expense		2,090,468
	Retained Earnings		3,580,077

Account	Beginning Balance (February 28th, 2009)	1. Purchase Inventory	2. Incur Factory Wages	3. Sell Inventory for Cash and On Account	4.Pay for Inventory	5. Collect Receivables	6. Incur SG&A (Cash and Payable)	7. Pay Wages	8. Receive Franchise Fees	9. Purchase PPE	10. Dividends Declared and Paid	11. All Other Transactions	Unadjusted Trial Balance	12. Adjust for Inventory Count	13. Record Depreciation	14. Wage Accrual	15. Consultant's Report	Pre-Closing Trial Balance	16. Closing Entry	Post-Closing (Ending) Balance
Cash and Cash Equivalents	1,253,947			17,000,000	-8,200,000	4,100,000	-2,000,000	-6,423,789	125,000	-498,832	-2,403,458	790,224	3,743,092					3,743,092		3,743,092
Accounts Receivable	4,229,733			5,000,000		-4,100,000						-702,207	4,427,526					4,427,526		4,427,526
Notes Receivable, Current	0											91,059	91,059					91,059		91,059
Inventories	4,064,611	7,500,000	6,000,000	-14,000,000								-66,328	3,498,283	-216,836				3,281,447		3,281,447
Deferred Income Taxes	369,197											92,052	461,249					461,249		461,249
Other	224,378											-4,215	220,163					220,163		220,163
Property and Equipment, Net	5,253,598									498,832		132,859	5,885,289		-698,580			5,186,709		5,186,709
Notes Receivable, Less Current	124,452											139,198	263,650					263,650		263,650
Goodwill, Net	1,046,944												1,046,944					1,046,944		1,046,944
Intangible Assets, Net	183,135											-73,110	110,025					110,025		110,025
Other	91,057											-3,007	88,050					88,050		88,050
Accounts Payable	1,074,643	7,500,000			-8,200,000							503,189	877,832					877,832		877,832
Accrued Salaries and Wages	423,789		6,000,000					-6,423,789					0			646,156		646,156		646,156
Other Accrued Expenses	531,941						3,300,000					-2,885,413	946,528					946,528		946,528
Dividend Payable	598,986										3,709	-1	602,694					602,694		602,694
Deferred Income	142,000								125,000			-46,062	220,938					220,938		220,938
Deferred Income Taxes	827,700											66,729	894,429					894,429		894,429
Common Stock	179,696											1,112	180,808					180,808		180,808
Additional Paid-In-Capital	7,311,280											315,322	7,626,602					7,626,602		7,626,602
Retained Earnings	5,751,017										-2,407,167		3,343,850					3,343,850	3,580,077	6,923,927
Sales	0			22,000,000								944,017	22,944,017					22,944,017	-22,944,017	0
Franchise and Royalty Fees	0											5,492,531	5,492,531					5,492,531	-5,492,531	0
Cost of Sales	0			14,000,000								693,786	14,693,786	216,836				14,910,622	-14,910,622	0
Franchise Costs	0											1,499,477	1,499,477					1,499,477	-1,499,477	0
Sales and Marketing	0						1,505,431						1,505,431					1,505,431	-1,505,431	0
General and Administrative	0						2,044,569					-261,622	1,782,947			639,200		2,422,147	-2,422,147	0
Retail Operating	0						1,750,000						1,750,000			6,956		1,756,956	-1,756,956	0
Depreciation and Amortization	0												0		698,580			698,580	-698,580	0
Interest Income	0											-27,210	-27,210					-27,210	27,210	0
Income Tax Expense	0											2,090,468	2,090,468					2,090,468	-2,090,468	0
A = L + OE + R - E	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	-3,580,077		

Transaction	Classification
1. Purchase Inventory	Operating Activity
2. Incur Factory Wages	Operating Activity
3. Sell Inventory (Cash and Account)	Operating Activity
4. Pay For Inventory	Operating Activity
5. Collect Receivables	Operating Activity
6. Incur SG&A (Cash and Payable)	Operating Activity
7. Pay Wages	Operating Activity
8. Receive Franchise Fees	Operating Activity
9. Purchase PPE	Investing Activity
10. Dividends Declared/Paid	Financing Activity
11. All Other Transactions	N/A
12. Inventory Count Adjustment	Operating Activity
13. Record Depreciation	Operating Activity
14. Wage Accrual	Operating Activity
15. Consultant's Report	N/A

Rocky Mountain Chocolate Factory, Inc. Income Statement For Year Ended February 28, 2010		
Sales	22,944,017	
Franchise and Royalty Fees	5,492,531	
Total Revenues		28,436,548
Cost of Sales	14,910,622	
Franchise Costs	1,499,477	
Sales & Marketing	1,505,431	
General and Administration	2,422,147	
Retail Operating	1,756,956	
Depeciation and Amortization	698,580	
Total Operating Expenses	(-)	22,793,213
Interest Income	(-)	-27,210
Income Before Tax		5,670,545
Income Tax Expense	(-)	2,090,468
Net Income		3,580,077

Rocky Mountain Chocolate Factory, Inc. Balance Sheet For Year Ended February 28, 2010		
Assets		
Current Assets		
Cash and Cash Equivalents	3,743,092	
Accounts Receivable	4,427,526	
Notes Receivable, Current	91,059	
Inventories	3,281,447	
Deferred Income Taxes	461,249	
Other Current Assets	220,163	
Total Current Assets		12,224,536
Long Term Assets		
Property and Equipment, Net	5,186,709	
Notes Receivable Less Current	263,650	
Goodwill, Net	1,046,944	
Intangible Assets, Net	110,025	
Other Long Term Assets	88,050	
Total Long Term Assets		6,695,378
Total Assets		18,919,914
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	877,832	
Accrued Salaries and Wages	646,156	
Other Accrued Expenses	946,528	
Dividend Payable	602,694	
Deferred Income	220,938	
Total Current Liabilities		3,294,148
Deferred Income Taxes		894,429
Total Liabilities		4,188,577
Stockholders' Equity		
Common Stock	180,808	
Additional Paid-In-Capital	7,626,602	
Retained Earnings	6,923,927	
Total Stockholders' Equity		14,731,337
Total Liabilities and Stockholders' Equity		18,919,914

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 4

Consulting Group

Group 2

Parker Durham

Rachel Rutledge

Mary Elizabeth Gentry

Allison Floyd

Ryan Maddigan

Swede Umbach

Executive Summary:

Kayla, thank you for hiring Group 2 Consulting Group, LLC. We have evaluated your operations and have identified areas where fraud might occur. Along with these identified areas, we have provided our recommendations of internal control that will help eliminate these possibilities of fraud. Please see our recommendations in the table provided below.

Problem Susceptible to Fraud	Recommended Control
Lucy records daily sales and prepares the corresponding bank deposits.	You should implement a segregation of duties so there is a different person recording sales and making bank deposits.
While the automatic update of the perpetual inventory system is efficient, not verifying the physical inventory count to the perpetual inventory count on the books is a problem.	Have another employee conduct a physical inventory count weekly and report any discrepancies between the count and the recorded book value.
Lucy has access to the accounting system, even though she is in charge of making bank deposits.	There should be a segregation of duties so a different person handles the accounting system than the one who makes bank deposits.
While the unique code is a start for preventing unauthorized access to the registers, it is susceptible to theft by another employee.	Add another control measure by requiring employees to swipe a provided employee key card in addition to the unique employee code. Such a control will help prevent unauthorized or fraudulent access to the registers.
You are monitoring the perpetual inventory records and ordering inventory.	Instead of this, have your employee in charge of taking a physical inventory count provide you with the inventory on hand, upon which you order the required inventory needed.
You are taking the deposits to the bank and reconciling the bank statements.	These duties should be separated, as the same person doing both duties opens the door to fraud as well as tainting the independence of the reconciler.
No checks or reconciliations of daily transactions .	While autonomy of the employees is important, you or Lucy should check the validity of every transaction, as well as reconcile the transactions with the cash on hand.

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 5

Inventory Impairment

By Ryan Maddigan

1. One would expect to find the historical cost of raw materials that are involved directly in the end product. If the manufacturer were to be making baseball bats, the historical cost of the wood used to make the wooden baseball bats would be the value of raw materials inventory. In work in process inventory, costs can include the costs of the materials as well as the direct labor and overhead allocated to the process of converting the goods. For example, the cost of the wood undergoing carving to become baseball bats along with the costs for any carvers working on the bats. The cost of pay for managers as well as anyone not directly working on the bats but involved with the operations is included with the indirect labor and other costs adjunct to the production of the bats such as the use of glue or other things not directly involved in the production. Finally, finished goods inventory would include the cost of the bats that have been completed but have not yet been sold.

2. Inventories are net of gross inventory minus the allowance for obsolete or unmarketable inventory. So, the sum of the material, labor, and overhead costs involved in raw materials, work in process, and finished goods inventories minus the goods that cannot be sold would be considered net of inventories.

3. a) The allowance for obsolete and unmarketable inventory is a contra-inventory account. It appears in the same section as inventories on all financial statements since it directly decreases that account.

b) Year End 2011: 233,070 (net inventory) + 10,800 (end obsolete/unmarketable inventory) = $243,870

Year End 2012: 211,734 (net inventory) + 12,520 (end obsolete/unmarketable inventory) = $224,254

c) 2011: Raw Materials - 46,976/233,070 * 10,800 = $2,177

Work in Process – 1,286/233,070 * 10,800 = $60

Finished Goods – 184,808/233,070 * 10,800 = $8,564

2012: Raw Materials - 43,469/211,734 * 12,520 = $2,570

Work in Process – 619/211,734 * 12,520 = $37

Finished Goods – 167,646/211,734 * 12,520 = $9,913

4.

	Debit	Credit
Cost of Sales	13,348	
Allowance for Obsolete or Unmarketable Inventory		13,348
Allowance for Obsolete or Unmarketable Inventory	11,628	
Cost of Sales		11,628

5.

Raw Materials, Net

Debit	Credit
46,976	
	442,068
438,561	
43,469	

Work-in-Process, Net

Debit	Credit
1,286	
	568,735
126,000	
442,068	
619	

Finished Goods, Net

Debit	Credit
184,808	
	13,348
	584,177
11,628	
568,735	
167,646	

Cost of Sales

Debit	Credit
0	
584,177	
13,348	
	11,628
585,897	

Accounts Payable

Debit	Credit
	39,012
	438,561
432,197	
	45,376

a) Cost of Finished Goods Sold = $584,177

b) Cost of Finished Goods Transferred from Work-in Process = $568,735

c) Cost of Raw Materials Transferred to Work-in-Process = $442,068

d) Cost of Raw Materials Purchased = $438,561

e) Cash Disbursed for Raw Materials Purchases = $432,197

6. Inventory Turnover Ratio:

2011: 575,266/((268,591+233,070)/2) = 2.29

2012: 585,897/((233,070+211,734)/2) = 2.63

7. Inventory Holding Period:

2011: 365/2.29 = 159 average days to sell inventory

2012: 365/2.63 = 139 average days to sell inventory

The company has become more efficient in the sale of its inventory between the years 2011 and 2012, as the average days to sell inventory dropped by 20 days. This may indicate increasing sales and generally better performance by the company.

8. Percent of Obsolete Finished Goods:

2012: 13,348/167,646 = 7.96%

As an investor or analyst, I would like to see a price to earnings ratio to determine if the company is accurately valued by the market.

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 6

WorldCom

By Ryan Maddigan

a) *i*. Assets – Future economic benefits that result from transactions that occurred prior to being recognized.

Expenses – Outflows from the using up of assets, the incurrence of liabilities or other activities.

ii. In general, costs should only be capitalized to an asset when the cost from the activity will create revenues in the future. If it only produces present value and does not create value in the future then they should be expensed.

b) Costs when they are capitalized are debited to the property and equipment accounts and are included as such in the balance sheet. The capitalization rather than expensing of the costs also creates an overstated amount for both accumulated depreciation and net income on the statement of cash flows.

	Debit	Credit
c) Line costs (Expense)	14,739,000,000	
Cash		14,739,000,000

The line costs debited in this transaction consist of charges paid to local phone networks for completing the calls necessary to conduct business and include primarily transport and access costs.

d) The costs that were improperly capitalized to the property and equipment account "Transmission Equipment" were charges paid to local telephone networks the company

was using to complete its calls such as access and transport charges. These do not fit the definition of assets because no future economic benefits are certain from the payment of these charges and even if benefits did come from the activities, it is difficult to attribute these benefits to those charges in particular. It would be defined as an expense and treated as such.

e) PPE (Asset) 3,055,000,000

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

$3,055,000,000 of line costs were improperly added to the property and equipment account "Transmission Equipment", which greatly overstated this asset on the balance sheet. This resulted in WorldCom overstating depreciation expense in the statement of cash flows and the effect of the incorrect capitalization can be found in this account.

f) (771,000,000/22 years)*(4/4) quarters = 35,045,455

(610,000,000/22 years)*(3/4) quarters = 20,795,455

(743,000,000/22 years)*(2/4) quarters = 16,886,364

(931,000,000/22 years)*(1/4) quarters = 10,579,546

$83,306,820

Depreciation Expense 83,306,820

Accumulated Depreciation – Transmission Equipment 83,306,820

g) Income before taxes, as reported	$2,393,000,000
Add back depreciation for year from part f	83,306,818
Deduct line costs that were improperly capitalized	{3,055,000,000}
Loss before taxes, restated	{578,693,182}
Income Tax Benefit (35%)	202,542,614
Minority interest	35,000,000
Net Loss, restated	**{$341,150,568}**

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 7

Targa Co.

By Ryan Maddigan

1) Accounting for Employee Benefits

Targa Co. plans to terminate much of the workforce in its Plant A facility, making up 10% of its total workforce. They are to provide these employees with 10 weeks of pay, resulting in a one-time termination benefit of $2.5 million as well as the historical practice of providing 2 weeks of pay, which will cost the company $500,000. Another termination obligation the company incurs is a lump-sum benefit of $50,000 to the facility manager. But how is Targa to record these obligations? First we must classify the transaction. ASC 420-10-25-4 describes the criteria necessary for the transaction to be classified as a one-time employee termination benefit, which includes

- "a. Management, having the authority to approve the action, commits to a plan of termination.
- b. The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.
- c. The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.

- d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn".

Such transactions may be, according to ASC 712-10-05-2, "paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means". As the company did not indicate that it was setting up a new account for the benefit plan, it can be assumed that the benefits are to be paid directly from Targa Co. assets, creating a liability. ASC 420-10-25-9 in the codification expands on this, stating that such liabilities "shall be measured initially at the communication date based on the fair value of the liability as of the termination date". Therefore, on December 27th, 20X1 (the communication date), the company should record $3,000,000 as a long-term liability and the $50,000 lump sum due to the facility manager as a short-term liability. Once the employees accept the offer, however, the amount the employees accept is to be subsequently recorded as a loss as prescribed in ASC 712-10-25-1.

2) Accounting for Relocation and Retraining Costs

Targa will also incur a relocation and staff training cost in order to set up their new facility in a new location, costing $500,000 and $2,500,000 respectively. These costs fall under those associated with exit and disposal activities, as outlined in ASC 420-10-25-14. The very next section in the codification explains what should be done with

such exit and disposal activities. According to ASC 420-10-25-15, “A liability for other costs associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred (generally, when goods or services associated with the activity are received)”. So, Targa Co. is to record a liability not in its 20X1 balance sheet, but when it proceeds with relocation. We assume that the staff training costs are associated with relocation, so we therefore record a liability of $2,000,000 when the company undergoes relocation activities in the year 20X2.

NOTE: Targa Co. may be in violation of the Worker Adjustment and Retraining Notification Act. In ASC 420-10-25-7 the Act “as of 2002 required entities with 100 or more employees to notify employees 60 days in advance of covered plant closings and mass layoffs, unless otherwise specified”. The company communicated its workforce reduction plans on December 27, 20X1 and plans to complete the workforce reduction by January 31st of the subsequent year (20X2), giving only 35 days of notice. Therefore Targa may have to delay executing its workforce reduction plan in order to comply with federal law.

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 8

Merck Inc.

By Ryan Maddigan

a)

i. 5,400,000,000 shares

ii. 2,983,508,675 shares

iii. $29,835,086.75

iv. 811,005,791 shares

v. 2,172,502,884 shares outstanding (2,983,508,675 issued – 811,005791 in treasury)

vi. $125.2 billion market capitalization (2,172,502,884 shares outstanding x $57.61 share price)

c)

Companies pay dividends on their common and ordinary shares to keep their shareholders happy as well as to attract new investors to the company. Issuing dividends does cause the price to go down however, as the company is using money to pay dividends that could have gone towards operations, making more money and furthering the interests of the company and its investors.

d)

Companies may repurchase their own shares to reduce the cost of capital and pay off investors. It also causes EPS to increase as the number of outstanding shares decreases. Another reason companies might repurchase shares is to buy them when the stock price dips then sell them again once the price is higher.

e) Retained Earnings 3,310.7M

Dividends Payable 3.4M

Cash 3,307.3M

g)

i. Merck uses the cost method to account for purchases of treasury stock

ii. 26.5 million shares repurchased

iii. $1,429.7M; $53.95/share ($1,429.7M/26.5M shares purchased)

iv. Treasury stock is not disclosed as an asset in Merck's financial statements because although the company can earn future economic benefit by buying back stock and selling it for a higher price it cannot earn future income from the treasury stock.

i)

	Merck ($)	
(In Millions)	**2007**	**2006**
Dividends Paid	$3,307.3	$3,322.6
Shares Outstanding	$2,172.5	$2,167.8
Net Income	$3,275.4	$4,433.8
Total Assets	$48,350.7	$44,569.8
Operating Cash Flows	$6,999.2	$6,765.2
Year End Stock Price	$57.61	$41.94
Dividends Per Share	1.52	1.53
Dividend Yield (Dividends per Share to Stock Price)	2.66%	3.65%
Dividend Payout (dividends to Net Income)	1.01	0.75
Dividends to Total Assets	0.068	0.075
Dividends to Operating Cash Flows	0.47	0.49

On my honor, I pledge that I have neither given, received, nor witnessed any authorized help on this case study.

Signed: Ryan Maddigan

Case 9

Xilinx Inc: Stock-Based Compensation

By Ryan Maddigan

a) The equity investment plan is a plan for compensation to employees of Xilinx Inc. in which the company awards compensation to certain employees of the company in the form of common stock in Xilinx. This can come in the form of regular stock or restricted stock units (RSUs), both of which allow the employee to benefit from the success of the company as the market price of the company's stock increases if the employee decides to purchase stock. Some of the benefits employees can derive from a plan such as this one are increased connectedness to the company and its success, financial gains well above their annual salary if the company is stable and successful, a good long-term investment plan as well as some tax benefits.

b) Stock options differ from restricted stock units in that options are essentially the opportunity to buy stocks at a set price while the use of RSUs allows the employee to receive a grant valued in terms of Xilinx stock and the actual shares of stock (or the cash value of those shares) when the time period outlined is elapsed and the RSUs fully vest. RSUs are therefore seen as a "safer" form of compensation for the employee in that they will receive shares regardless of the price while normal stock options can be purchased at a set price but can be rendered worthless if the company gets in financial trouble and the market price dips significantly. Both options are often offered to employees as many employees want a stake in the company but some are willing to take more risk than others with their equity-based compensation. Employees receiving a stake in the company in either form is beneficial for Xilinx in that these options are

contingent of the employees remaining with the company and employees are more likely to remain so that they do not have to give up the financial benefits of the stock.

c) Grant date – The date on which the stock option, cash value of the option, or other reward is given to an employee

Exercise price – The price at which the stock in the stock option plan can be purchased or sold

Vesting period – The period in which the employee has to wait in order to exercise the stock options granted during which the employee accrues rights to the company stock

Expiration date – The last day that the stock options contract is valid and options can be exercised

Options/RSU granted – Stock options or rights to restricted stock (after vesting) given to an employee

Options exercised - Buying stock at the strike price agreed upon in the compensation package

Options/RSUs forfeited/cancelled – Stock options or RSUs that are never exercised or fully vested usually due to either the employee leaving the company or violating the terms of the initial stock purchase

d) The plan works similarly to the employee stock option plan in that it allows employees to purchase stock of the company during a certain period. However, one big

incentive for employees with regard to the purchase plan is that they are allowed to purchase the stock at 85% of the lower of fair market value of the stock at the beginning or end of the period. It also differs in that there is a specified 24 month period in which the employees can purchase this discounted stock.

e) For stock-based compensation, Xilinx is to account for the equity paid to employees as compensation expense at the cost of the grant-date fair value of the awards given to employees. It is also to record the unvested portion of previously granted awards as compensation expense. These costs of compensation are to be recognized using the straight-line method over the period. The treatment for RSUs is similar in that they are valued at the date of the grant and recognized and treated as compensation expense over the course of the vesting period. As for the purchase plan, when an employee purchases stock using the plan the cash used to purchase it is debited while the stock discount (15%) times the number of stocks purchased is to be recorded as compensation expense. Common stock would be credited.

f)

i. $77,862

ii. This expense is included under “Cost of Revenues” because compensation to employees is essential to produce revenues for the company. They are not operating

expenses because they are not expenses incurred through normal business operations but rather through negotiations with its employees.

iii. The expense decreases net income so therefore causes income from operating activities to be lower. However, the proceeds from the issuance of common stock through stock purchase plans and tax benefits causes an overall increase in cash from financing activities.

iv. The use of stock-based compensation plans for employees caused an excess $10,156 tax benefit to the company, which is reported under the cash flows from financial activities section.

v.

Account	Debit	Credit
Cost of Goods Sold	6,356	
Research + Development Expense	37,937	
Selling, General + Admin Expense	33,569	
Additional Paid-In Capital- S/O		77,862
Deferred Tax Asset	22,137	
Income Taxes Payable		22,137

i)

i. The main idea of the article is that stock options as compensation for employees has greatly declined, with both employees and employers alike gravitating more towards RSUs. The reasons for this are varied, but for employers RSUs are less

complicated tax-wise, as they are subject to fewer tax and accounting complexities and are more uniform across the business world. Also the article states that a big reason for this switch is that in 2006 accounting rules changed to have stock options recorded as expenses. A reason companies are using restricted shares instead is that they are worth more, so fewer are given out and major dilution is avoided. As for why fewer employees want stock options for compensation, the problem lies in the risk, as stocks trading below the strike price are essentially worthless. RSUs have no such problem. Therefore, employees overwhelmingly seem to prefer the restricted stock options.

ii. Yes, the trend of grants for both stock option and RSU compensation follow the trend outlined in the article. The number of stock option shares granted was 2,345 in fiscal year 2010 but had declined to 92 in fiscal year 2012. On the other hand, RSU stock options granted to employees rose from 2,043 in 2010 to 3,018 in 2012 as they overtook stock option compensation in favorability for the business and the employees.

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case study.

Signed: Ryan Maddigan

Case 10

Bier Haus

By Ryan Maddigan

Part 1:

a) How does each step in the five-step revenue model apply to this transaction?

Step 1 - Identify the Contract: Beer is exchanged for money.

Step 2 - Performance Obligation: Bier Haus gives the customer a large plastic cup of beer.

Step 3 - Determine the Transaction Price: The price for one large plastic cup of beer is $5.

Step 4 - Allocate the Transaction Price to Performance Obligations in Contract: The cost of $5 is allocated to the large plastic cup of beer.

Step 5 - Recognize revenue when (or as) the entity satisfies the performance obligation: The performance obligation is met when the bartender hands the customer the large plastic cup of beer, so therefore revenue is recognized.

b) Prepare the journal entry to record the transaction.

Cash	$5.00	
Sales Revenue		$5.00

Part 2:

a) How does each step in the five-step revenue model apply to this transaction?

Step 1 - Identify the Contract: Beer and a thermal beer mug are exchanged for money.

Step 2 - Performance Obligation: Bier Haus delivers to the customer the thermal beer mug.

Step 3 - Determine the Transaction Price: The transaction price for the bundle of the thermal beer mug and the beer is $7.

Step 4 - Allocate the Transaction Price to Performance Obligations in Contract: The cost of $4.38 ($7 * 5/8) is allocated to the mug while the relative sales value of the beer is allocated to be $2.62 ($7 * 3/8).

Step 5 - Recognize revenue when (or as) the entity satisfies the performance obligation: Sales revenue of $4.38 is recognized for the mug and $2.62 is recognized for the beer at the time that the bartender delivers the mug with the beer to the customer.

b) Prepare the journal entry to record the transaction.

Cash	$7.00	
Sales Revenue – Mug		$4.38
Sales Revenue – Beer		$2.62

Part 3:

a) How does each step in the five-step revenue model apply to this transaction?

Step 1 - Identify the Contract: The contract is the exchange of money for a large beer and pretzels, however the contract is open until the coupon given to the customer is exchanged for the pretzels.

Step 2 - Performance Obligation: The performance obligation is the delivering of the beer and pretzel coupon to the customer and eventually the giving of the pretzels in exchange for the coupon.

Step 3 - Determine the Transaction Price: The transaction price for the beer and the coupon is $7.

Step 4 - Allocate the Transaction Price to Performance Obligations in Contract: $4.12($7 * 5/8.50) is allocated to the beer while $2.88 ($7 * 3.50/8.50) is allocated to the coupon.

Step 5 - Recognize revenue when (or as) the entity satisfies the performance obligation: Revenue is recognized on two separate occasions, once when money is exchanged for beer and the coupon and again when the coupon is exchanged for pretzels.

b) Prepare the journal entry to record the transaction.

Cash	$7.00	
Unearned Revenue		$2.88
Sales Revenue – Beer		$4.12

Part 4:

a) How does each step in the five-step revenue model apply to this transaction?

Step 1 - Identify the Contract: A coupon is exchanged for two pretzels.

Step 2 - Performance Obligation: The performance obligation is completed when the bartender gives the student the two pretzels.

Step 3 - Determine the Transaction Price: The transaction price is $2, the price of the coupon.

Step 4 - Allocate the Transaction Price to Performance Obligations in Contract: The $2 transaction price is allocated to the coupon.

Step 5 - Recognize revenue when (or as) the entity satisfies the performance obligation: $2 of revenue is recognized when the pretzels are delivered to the customer.

b) Prepare the journal entry to record the transaction.

Unearned Revenue	$2.00	
Sales Revenue – Pretzel/Coupon		$2.00

On my honor, I pledge that I have neither given, received, nor witnessed any unauthorized help on this case study.

Signed: Ryan Maddigan

Case 11

ZAGG Inc.

By Ryan Maddigan

a) Book income, or financial income, is income that includes both taxable and nontaxable income, which is represented by $33,491. It differs from taxable income in that temporary, permanent, and loss carryforwards can cause a change in income.

b) Permanent tax differences are differences that never reverse, or items of book revenue or expense revenue but are never considered tax revenue or expense.

Temporary tax differences are differences that are considered in one period for taxes and another period for the books.

Statutory Tax - Tax imposed by law, usually expressed as a percentage.

Effective Tax – Effective tax rate at which an individual or corporation is taxed and is actually applied

c) In order to follow the matching principle and have income taxes reported in the same year as they are incurred, a company should report deferred income taxes, not just the taxes that are payable now.

d) Deferred tax liability is the deferred tax consequences attributable to taxable temporary definitions. It represents an increase in taxes payable in future years as a result of taxable temporary differences existing at the end of the current year. An example is a difference in depreciation methods causes accounting income to be higher than taxable income so the difference is held as a deferred tax liability until paid.

Deferred tax asset is the deferred tax consequence attributable to deductible temporary differences. It represents the increase in taxes refundable in future years as a result of deductible temporary differences existing at the end of the current year. An example is a deduction in expenses based on expected warranties that are not permitted to be recognized in the period but the difference in the taxes paid and what would be paid is booked as the deferred tax asset.

e) A deferred income tax value allowance is a situation in which a business creates an account because there is more than a 50% probability that the company will not realize some portion of a deferred tax asset. It is likely to be created and should be recorded if the company expects to incur losses in the next few years or historically lets carryforwards expire unused. For example, if a company previously recorded a deferred tax asset but doesn’t think there will be enough profits to offset the tax assets, it creates the allowance account to offset it.

f)

i. Income Tax Expense	9,393	
Net Deferred Tax Asset	8,293	
Income Tax Payable		17,686
ii. Income Tax Expense	9,393	
Deferred Tax Asset	8,002	
Deferred Tax Liability	291	
Income Tax Payable		17,686

iii. 9,393/23,898 = 39.3%

iv. Deferred Income Tax Assets under current assets is the current portion and the Deferred Income Tax Assets as its own category after intangible assets is the noncurrent portion.

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Signed: Ryan Maddigan

Case 12

Build-A-Bear

By Ryan Maddigan

a) Companies may lease assets rather than buying them because they feel like purchasing may not be the best use of cash for the company. This is true for companies that do not need to own the asset and only need it for a set amount of time. Companies decide to lease because of the various benefits such as not having to own a depreciating asset, there are tax benefits of doing so, and cash that would have been spent on buying the asset can be used to finance growth.

b) An operating lease is a form of lease in which the lessee is allowed simply to use the asset leased to them and transfers the property back to the lessor after the lease period has expired. The lease expense is treated as an operating expense on the income statement but the lease itself does not affect the balance sheet. A capital lease differs in that the lessee assumes some of the risks and benefits of ownership in the property, booking both the asset and a liability for the lease payments. Two types of capital leases include the direct-financing lease and the sales-type lease. The direct-financing lease is essentially the coupling of a sale and financing transaction in which the lessor (lease owner) removes the asset from its books and gets a receivable from the lessee. A sales-type lease is similar but profit on the sale is recognized at the inception of the lease, with interest being recognized throughout the lease period.

c) Accountants distinguish between different types of lease because it gives users a better picture of the company's activities and obligations. Since a lease is a long-term

commitment, users and those looking through the financial statement should know not only how much the leasing of an asset is going to cost the company but how and under what terms the agreement is being financed.

d)

i. The lease will be treated as an operating lease because the lease does not qualify under any of the criteria that would classify it as a capital lease. The lease life does not exceed 75% of the life of the asset, there is no transfer of ownership to the lessee (Build-A-Bear) at the end of the lease term, there is not an option to purchase the asset at a "bargain price" at the end of the lease term and the present value of the lease payments, discounted at an appropriate discount rate doesn't exceed 90% of the fair market value of the asset.

ii.

Year 1:

	Debit	Credit
Rent Expense	100,000	
Deferred Rent (Liability)		100,000

Years 2 – 5:

	Debit	Credit
Rent Expense	100,000	
Deferred Rent	25,000	
Cash		125,000

e)

i. 45.9M total office and retail store base rent expense + 0.9M contingent rent = $46.8M

ii. The rent expense of $46.8 million is under selling, general, and administrative expense.

f)

i.

Period	Specific lease payments	PV Factor	PV of payments
1	50,651	0.9346	47,337
2	47,107	0.8734	41,145
3	42,345	0.8163	34,566
4	35,469	0.7629	27,059
5	31,319	0.7130	22,330
6	25,229	0.6663	16,811
7	25,229	0.6227	15,711
8	25,229	0.5820	14,684
	$282,578		**$219,644**

ii. Property and Equipment 219,644

Lease Obligation 219,644

v. Lease Obligation 35,276

Interest Expense 15,375 (219,644*.07)

Cash 50,651

Depreciation Expense 27,456 (219,644/8)

Accumulated Depreciation – PPE 27,456

g) Build-A-Bear has several incentives to structure its leases as operating leases rather than capital leases since operating leases grant a lot more flexibility for the company and Build-A-Bear is protected from the risk of obsolescence. Another benefit is that the accounting is simpler, the firm doesn't have to put the asset on its balance sheet or record

its corresponding debt liability. Operating leases in particular can make it a bit more difficult to get a full picture of the company's financial position from the financial statements only, but notes should make things more clear. Overall leasing should not affect the quality of financial reporting if users are willing to look at the details of the arrangements in the notes and companies disclose everything they are required to under GAAP regarding the leasing transactions.

h)

i. The entry in part f would affect the current ratio, debt to equity ratio, and long term debt to assets ratio like so:

	Original Assets	Potential Impact
Current Ratio	1.66	1.83
Debt-to-Equity	2.06	2.30
LT Debt-to-Assets	0.51	0.11

The current ratio would increase from 1.66 to 1.83. The increase in the short-term debt caused by the lease obligation the company would take on with a capitalized lease would be offset. The debt-to-equity ratio increases due to this lease obligation as well, as total debt is increased but equity stays constant. This indicates that Build-A-Bear would use more debt to finance its assets if it were to capitalize the lease compared to if it were to keep it as an operational lease. The long term debt-to-assets ratio decreases from 0.51 to 0.11 because assets in the form of property and equipment increases as the company takes on the property while long term debt stays constant.

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Signed: Ryan Maddigan

LIST OF REFERENCES

NOTE: ALL WORK AND CASE ANSWERS INCLUDED IN THIS PROJECT ARE THE WRITER'S OWN THOUGHTS, OPINIONS, AND INTERPRETATIONS, WITH THE ONLY OUTSIDE RESOURCE BEING THE FASB ACCOUNTING STANDARDS CODIFICATION