DELVING INTO CORPORATE ACCOUNTING

by

Allison Ann Floyd

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

Oxford

May 2018

Approved by

____

Advisor: Professor Victoria Dickinson

© 2018
Allison Ann Floyd
ALL RIGHTS RESERVED

ABSTRACT

ALLISON ANN FLOYD: Delving into Corporate Accounting
(Under the direction of Dr. Victoria Dickinson)

Delving into Corporate Accounting uses the financial statements of companies within the corporate realm to highlight key accounting aspects. There are a couple of instances within this thesis where hypothetical situations were given to further investigate the role of a specific concept as it relates to the industry. This is made obvious by the presence of a series of questions.

Furthermore, the exploration of various accounting concepts was completed via Accountancy 420. My classmates and I conducted our studies on each concept over two semesters, fall 2016 and spring 2017. Ultimately, the collation of company research and hypothetical instances contributed to a deeper understanding of the industry.

Table of Contents

Eads & Glenwood Heating 7
Totz and Doodlez 18
Rocky Mountain Chocolate Factory 21
Inventory 26
World Com 28
Targa Company 30
Merck 31
Xilinx 32
Revenue 35
Zagg Company 37
Build-A-Bear 39

Eads & Glenwood Heating

This case seeks to convey the more profitable investment option by comparing the financial statements of two companies: Eads Co. and Glenwood Heating. The statement of cash flows is heavily utilized; thus, the numbers from these statements ultimately reveal which company yields a higher return on investment.

Financial Statements for Eads Heating

Eads Heating		
	Income Statement FYE 12/31/20X1	
Sales Revenue	$	398,500.00
Cost of Goods Sold	$	(188,800.00)
Gross Profit	$	209,700.00
Depreciation Expense	$	(41,500.00)
Bad Debt Expense	$	(4,970.00)
Other Operating Expenses	$	(34,200.00)
Income from Operations	$	129,030.00
Other Expenses and Losses		
Interest Expense	$	(35,010.00)
Income from Continuing Operations Before Tax	$	94,020.00
Income Tax 25%	$	(23,505.00)
Net Income	$	70,515.00

Statement of Changes in Stockholder's Equity FYE 12/31/20X1			
	Total	Retained Earnings	Common Stock
Beg. Bal	160,000	---	160,000
Net Income	70,515	47,315	---
Ending Bal	230,515	47,315	160,000

Statement of Cash Flows				
	FYE 12/31/20X1			
Cash from Operating Activities				
Net Income			$	70,515.00
Adjustments				
Bad Debt Expense		$ 4,970.00		
Depreciation Expense		$ 41,500.00		
Accounts Receivable		$ (99,400.00)		
Inventory		$ (51,000.00)		
Accounts Payable		$ 26,440.00		
Interest Payable		$ 6,650.00		
			$	(70,840.00)
Net Cash from Operating Activities			$	(325.00)
Cash from Investing Activities				
Land		$ (70,000.00)		
Building		$ (350,000.00)		
Equipment		$ (80,000.00)		
Net Cash from Investing Activities			$	(500,000.00)
Cash from Financing Activities				
Payment for Lease		$ (8,640.00)		
Cash from Common Stock		$ 160,000.00		
Cash from Note Payable		$ 380,000.00		
Payment of Dividends		$ (23,200.00)		
Net Cash from Financing Activities			$	508,160.00
Total Net Cash			$	7,835.00

			Classified Balance Sheet	
			FYE 12/31/20X1	
		Assets		
Current Assets				
Cash			$ 7,835.00	
Accounts Receivable		$ 99,400.00		
Allowance for Doubtful Accounts		$ 4,970.00		
			$ 94,430.00	
Inventory			$ 51,000.00	
Total				$ 153,265.00
Property, Plant, & Equipment				
Land			$ 70,000.00	
Building		$ 350,000.00		
Accumulated Depreciation		$ (10,000.00)		
			$ 340,000.00	
Equipment		$ 80,000.00		
Accumulated Depreciation		$ (20,000.00)		
			$ 60,000.00	
Leased Equipment		$ 92,000.00		
Accumulated Depreciation		$ (11,500.00)		
			$ 80,500.00	
Total PPE				$ 550,500.00
Total Assets				$ 703,765.00

		Liabilities & Stockholders' Equity		
Current Liabilities				
Accounts Payable			$ 26,440.00	
Accrued Interest			$ 6,650.00	
Total				$ 33,090.00
Long-Term Liabilities				
Note Payable - 20 Years, 7%			$ 380,000.00	
Lease Payable			$ 83,360.00	
Total				$ 463,360.00
Total Liabilities				$ 496,450.00
Stockholders' Equity				
Common Stock- 3,200 Shares			$ 160,000.00	
Retained Earnings			$ 47,315.00	
				$ 207,315.00
Total Equity				
Total Liabilities & Equity				$ 703,765.00

Financial Statements for Glenwood Heating

Glenwood Heating	
Income Statement	
FYE 12/31/20X1	
Sales Revenue	$ 398,500.00
Cost of Goods Sold	$ (177,000.00)
Gross Profit	$ 221,500.00
Rent Expense	$ (16,000.00)
Depreciation Expense	$ (19,000.00)
` Bad Debt Expense	$ (994.00)
Other Operating Expenses	$ (34,200.00)
Income from Operations	$ 151,306.00
Other Expenses and Losses	
Interest Expense	$ (27,650.00)
ncome from Continuing Operations Before Tax	$ 123,656.00
Income Tax 25%	$ (30,914.00)
Net Income	$ 92,742.00

Classified Balance Sheet				
		FYE 12/31/20X1		
		Assets		
Current Assets				
Cash			$ 426.00	
Accounts Receivable		$ 99,400.00		
Allowance for Doubtful Accounts		$ (994.00)		
			$ 98,406.00	
Inventory				
Total				$ 161,632.00
Property, Plant, & Equipment				
Land			$ 70,000.00	
Building		$ 350,000.00		
Accumulated Depreciation		$ (10,000.00)		
			$ 340,000.00	
Equipment		$ 80,000.00		
Accumulated Depreciation		$ (9,000.00)		
			$ 71,000.00	
				$ 481,000.00
Total Assets				$ 642,632.00

	Liabilities & Stockholders' Equity		
Current Liabilities			
Accounts Payable		26440	
Accrued Interest		6650	
Total			$ 33,090.00
Long-Term Liabilities			
Note Payable 20 Years, 7%		380000	
Total			$ 380,000.00
Total Liabilities			$ 413,090.00
Stockholders' Equity			
Common Stock- 3,200 Shares		160000	
Retained Earnings		69542	
Total Equity			$ 229,542.00
Total Liabilities &			$ 642,632.00

Statement of Cash Flows			
FYE 12/31/20X1			
Cash from Operating Activities			
Net Income			$ 92,742.00
Adjustments			
Bad Debt Expense		$ 994.00	
Depreciation Expense		$ 19,000.00	
Accounts Receivable		$ (99,400.00)	
Inventory		$ (62,800.00)	
Accounts Payable		$ 26,440.00	
Interest Payable		$ 6,650.00	
			$ (109,116.00)
Net Cash from Operating Activities			$ (16,374.00)
Cash from Investing Activities			
Land		$ (70,000.00)	
Building		$ (350,000.00)	
Equipment		$ (80,000.00)	
Net Cash from Investing Activities			$ (500,000.00)
Cash from Financing Activities			
Cash from Issuance of Common Stock		$ 160,000.00	
Cash from Note Payable		$ 380,000.00	
Payment of Dividends		$ (23,200.00)	
Net Cash from Financing Activities			$ 516,800.00
Total Net Cash			$ 426.00

Trial Balance from Part A for Eads and Glenwood

	Trial Balance	
	Debits	**Credits**
Cash	$ 47,340.00	
Accounts Receivable	$ 99,400.00	
Inventory	$ 239,800.00	
Land	$ 70,000.00	
Building	$ 350,000.00	
Equipment	$ 80,000.00	
Accounts Payable		$ 26,440.00
Note Payable		$ 380,000.00
Interest Payable		$ 6,650.00
Common Stock		$ 160,000.00
Dividend	$ 23,200.00	
Sales		$ 398,500.00
Other Operating Expenses	$ 34,200.00	
Interest Expense	$ 27,650.00	
Total	$ 971,590.00	$ 971,590.00

Journal Entries for Part A Transactions

			Assets			
	Cash	Accounts Receivable	Inventory	Land	Building	Equipment
No. 1	$160,000					
No. 2	$400,000					
No. 3	($420,000)			$70,000	$350,000	
No. 4	($80,000)					$80,000
No. 5			$239,800			
No. 6		$398,500				
No. 7	$299,100	($299,100)				
No. 8	($213,360)					
No. 9	($41,000)					
No. 10	($34,200)					
No. 11	($23,200)					
No. 12						
Balances	$47,340	$99,400	$239,800	$70,000	$350,000	$80,000

=			Liabilities	+
	Accounts Payable	Interest Payable	Note Payable	
			$400,000	
	$239,800			
	($213,360)			
			($20,000)	
		$6,650		
	$26,440	$6,650	$380,000	

		Equity		
Common Stock	Dividends	Sales	Interest Expense	Other Operating Expenses
$160,000				
		$398,500		
			$21,000	
				$34,200
	($23,200)			
			$6,650	
$160,000	($23,200)	$398,500	$27,650	$34,200

Analysis:

Eads Heating seems to be the more desired company regarding investing. Based on the numbers present in the statement of cash flows, the net operating cash flow and the overall net cash flow are higher than the numbers present in Glenwood's statement of cash flows. However, some may find Glenwood to be a more attractive investment option because of its higher net income. In my opinion, either option is viable.

Totz and Doodlez

Totz, a SEC registrant, has its year end on the Saturday closest to January 31st. Fiscal years 2016, 2015, and 2014, which include 52 weeks each, ended on January 30, 2016; January 31, 2015, and January 25, 2014, respectively.

Totz manufactures and sells high quality, stylish children's clothing via loud, colorful stores. The stores also include Doodlez, an in-store art studio, which was introduced in the third quarter of fiscal 2015. These studios offer painting, pottery, and drawing classes.

1. Net Sales: Totz had net sales of $74.5 million in fiscal 2015 and $86.5 million in fiscal 2016; an increase of $12 million, or 16.1%. The increase in net sales was driven, in part, by an increase in revenue from services provided by Doodlez, which increased from $3.9 million in fiscal 2015 to $11.2 million in fiscal 2016. The remaining increase in total net sales of $4.7 million was because of an increase in the average transaction value, driven by higher average retail sales on a per unit basis due to the favorable customer response to the use of more natural fibers in its garments.

    a. Solution: According to ASC 225-10-S99-2, the net sales of Totz should be reported separately from the revenue of Doodlez. These items should appear under sales in the operating section of the income statement (Intermediate Accounting, 16E). The net sales of Totz should not be combined with the revenue of Doodlez because the entity and its addition serve customers in different manners: Totz sells tangible products, and Doodlez sells its services.

2. Gross Profit: Gross Profit, which represents net sales less cost of sales, increased from $28 million in fiscal 2015 to $30.4 million in fiscal 2016; an increase of $2.4 million, or 8.6%. Cost of sales includes expenses incurred to acquire and produce inventory for sale, such as product costs, freight-in and import costs, and direct labor costs for Doodlez employees. However, cost of sales excludes depreciation. Cost of sales increased from $46.5 million in fiscal 2015 to $56.1 million in fiscal 2016; an increase of 9.6 million, or 20.6%, primarily as the result of an increase in the cost of Doodlez' services.

    a. Solution: Expenses such as product costs, freight-in and import costs, and direct labor cost for the employees of Doodlez should be reported under the operating section in the area designated "cost of sales" or "cost of goods sold" (Intermediate Accounting, 16E). In regard to the practice of cost of sales excluding depreciation, ASC 225-10-S99-8 states that there should be a line item that describes the exclusion. An example that the accounting

team of Totz and Doodlez may use is as follows: "Cost of goods sold (exclusive of depreciation shown separately below)." Furthermore, a figure stating income before depreciation should not be computed.

3. Gain on Sale of Corporate Headquarters: Totz relocated its corporate headquarters to Mountain View, CA. In connection with the relocation, Totz sold the abandoned building and realized a gain of $1.7 million on the sale.

    a. Solution: In my opinion, the gain on the sale of the corporate headquarters of Totz is an infrequent event, which is an event not expected to recur. According to ASC 225-10-S99-8, this sale should be presented in the income statement under the non-operating section in the designated area "Other Revenues and Gains" and should have furthered elaboration in the financial notes. The gain should also be shown at an amount that does not reflect a deduction of taxes since this section of the income statement is a component of "income before income taxes" (Intermediate Accounting, 16E).

4. Class Action Settlement: Totz became aware of the fact that the natural fiber materials provided by one of its fabric suppliers were not, in fact, natural. During fiscal 2016, Totz settled a class action lawsuit related to the legal case against the supplier in connection with this scandal and received proceeds of $2.7 million.

    a. Solution: From researching class action settlements related to clothing stores and suppliers (Nordstrom and AGAG), I have concluded that the environment in which Totz operates is susceptible to class action settlements and/or lawsuits, which makes this isolated event infrequent for the company but not necessarily unusual due to its environment. As referenced in #3, Totz company should adhere to the information present in ASC 225-10-S99-8, which states that the gain should be reported under the non-operating section in the designated area "Other Revenues and Gains" and should have furthered elaboration in the financial notes. The gain should also be shown at an amount that does not reflect a deduction of taxes since this section of the income statement is a component of "income before income taxes" line item (Intermediate Accounting, 16E).

Rocky Mountain Chocolate Factory

This case highlights how multiple transactions affect the financial statements of Rocky Mountain Chocolate Factory. The ultimate goal of it is to show how to close out operating accounts to the Income Summary and how to close out the Income summary to Retained Earnings.

Journal Entries

Account	Debit	Credit
Raw Materials Inventory	7500000	
Accounts Payable		7500000
Inventory (Direct Labor)	6000000	
Accrued Wages		6000000
Cash	17000000	
Accounts Receivable	5000000	
Sales		22000000
Costs of Sales	216836	
Inventory		216836
Accounts Payable	8200000	
Cash		8200000
Cash	4100000	
Accounts Receivable		4100000
Sales & Marketing Expenses	1505431	
G&A Expenses	2044569	
Retail Operating Expenses	1750000	
Accrued Expenses		3300000
Cash		2000000
Wages Payable	6423789	
Cash		6423789
Cash	125000	
Unearned Revenue		125000

Journal Entries

Account	Debit	Credit
PPE	498832	
Cash		498832

Account	Debit	Credit
Dividends	2407167	
Cash		2403458
Dividends Payable		3709

Account	Debit	Credit
Depreciation Expense	698580	
PPE		698580

Account	Debit	Credit
G&A Expense	639200	
Retail Operating Expense	6956	
Accrued Wages		646156

Closing Entries

Income Summary

Account	Debit	Credit
Sales	22944017	
Franchise & Royalty Fees	5492531	
Interest Income	27210	
Cost of Sales		14910622
Franchise Costs		1499477
Sales & Marketing Expenses		1505431
G&A Expenses		2422147
Retail Operating		1756956
Depreciation & Amortization		698580
Interest Expense		2090468
Income Summary		3580077

Account	Debit	Credit
Income Summary	3580077	
RE		3580077

Rocky Mountain Chocolate Factory
Balance sheet
FYE 2/28/10

Assets		**Liabilities &Stockholders' Equity**	
Current Assets		Accounts Payable	$ 877,832.00
Cash	$ 3,743,092.00	Accrued Salaries & Wages	$ 646,156.00
Accounts Receivable	$ 4,427,526.00	Other Accrued Expenses	$ 946,528.00
Notes Receivable	$ 91,059.00	Dividend Payable	$ 602,694.00
Inventory	$ 3,281,447.00	Deferred Income	$ 220,938.00
Deferred Income Taxes	$ 461,249.00	**Total Current Liabilities**	$ 3,294,148.00
Other	$ 220,163.00	**Deferred Income Taxes**	$ 894,429.00
Total Current Assets	$ 12,224,536.00	**Owners' Equity**	
PPE, Net	$ 5,186,709.00	Common Stock	$ 180,808.00
Other Assets		Additional PIC	$ 7,626,602.00
Notes Receivable	$ 263,650.00	Retained Earnings	$ 6,923,927.00
Intangible Assets	$ 110,025.00	**Total Equity**	$ 14,731,337.00
Goodwill, Net	$ 1,046,944.00	**Total Liabilities & Equity**	$ 18,919,914.00
Other	$ 88,050.00		
Other Total Assets	$ 1,508,669.00		
Total Assets	$ 18,919,914.00		

Rocky Mountain Chocolate Factory
Income Statement
FYE 2/28/10

Sales	
Sales	$ 22,944,017.00
Franchise & Royalty Fees	$ 5,492,531.00
Net Sales	$ 28,436,548.00
Costs & Expenses	
Costs of Sales, excluding depreciation and amortization	$ 14,910,622.00
Franchise Costs	$ 1,499,477.00
Sales & Marketing	$ 1,505,431.00
G&A	$ 2,422,147.00
Retail Operating	$ 1,756,956.00
Depreciation & Amortization	$ 698,580.00
Total Costs & Expenses	$ 22,793,213.00
Operating Income	
Other Income (Expense)	$ 5,643,335.00
Interest Expense	$ -
Interest Income	$ 27,210.00
Other, Net	$ 27,210.00
Income before Income Taxes	$ 5,670,545.00
Income Tax Expense	$ 2,090,468.00
Net Income	$ 3,580,077.00
Basic Earnings per Common Share	$ 0.60
Diluted Earnings Per Common Share	$ 0.58
WASO	$ 6,012,717.00
Dilutive Effect of Employee Stock Options	$ 197,521.00
WASO Assuming Dilution	$ 6,210,238.00

Inventory

This case seeks to give an all-encompassing review of inventory by giving many hypothetical situations that show the various ways that the inventory account can be treated.

1. Any costs associated with the product but not yet placed in production should be in the raw materials inventory. These costs include the cost of the actual material and the cost of shipping and should be directly traceable to the product.

   The cost of unfinished goods, direct labor, and overhead are costs that are found in the work in process account.

   Completed goods that have yet to be sold can be found in the finished goods inventory account.

2. Inventories are net of any contra inventory accounts such as the "allowance for obsolete or unmarketable inventory" account found below or an account such as "allowance to reduce inventory to the lower of cost or market".

3. The company discusses its allowance for obsolete or unmarketable inventory.
   a. The allowance for inventory account affects two statements, the balance sheet and income statement, and will ultimately appear on both: In regard to the balance sheet, this account should be coupled with the inventory account under assets just as accumulated depreciation is coupled with the asset to which it is assigned. In the income statement, this will appear as an expense, as it affects the "cost of goods sold" account: It does so because a business estimates the value of goods that are obsolete and then subtracts this number from the initial value of the goods. The resulting number is then debited to the "cost of goods sold" account.
   b. The balance for 2011 is $243,870. The balance for 2012 is $224,254.
   c. Inventory may become obsolete for a variety of reasons in each of the three types of inventory. Due to the reality of inventory remaining in raw materials for too long, I will estimate that a higher estimate of obsolete inventory will be found in raw materials. My estimates are 40% for raw materials inventory, 35% for work in process inventory, and 25% for finished goods inventory.
4. Provision for Obsolete Inventory 13,348

   Allowance for Obsolete Inventory 13,348

Allowance for Obsolete Inventory 11,628
Inventory 11,628

5.

Cost of Sales	
425,833	
13,348	
a: 146716	
585,897	

Accounts Payable	
	39,012
e: 6364	d: 12,728
	45,376

Raw Materials	
46,976	
d: 12,728	c: 16,235
43,469	

WIP	
1,286	
126,000	b: 142,902
c: 16,235	
619	

Finished Goods	
184,808	
	13,348
b: 142,902	a: 146,716
167,646	

6. Inventory Turnover: Cost of Sales/Average Inventories
   a. $585,897/$222,402 = 2.63
7. Inventory Holding Period: 365/Inventory Turnover Ratio
   a. 365/2.63 = 138.78
8. The company estimates that 7.4 will be the percentage of obsolete finished goods.
   *12,520/167,646

World Com

This case uses World Com to give an overview of income statement accounts. The account that is most prevalent is expenses. Hypothetical situations are given to show the impact of the expense account.

A. Assets are probable future economic benefits obtained or controlled by an entity because of past transactions or events. Expenses are outflows or other using up of assets or incurrences of liabilities from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

   i) Costs should be expensed when an item has been used and there is no economic value remaining, and an asset should be capitalized when all costs have not expired and economic value remains.

B. After initial capitalization, the cost is then amortized over its useful life. Profitability may be higher under cost capitalization because the amount paid will be in increments.

C. Line Costs (Expenses) $14,739,000,000
   Cash $14,739,000,000

   These line costs could be charges paid to local telephone companies to complete calls.

D. The telephone calls should have been treated as operating expenses but was instead deemed to be capital expenditures. They do not meet the definition of an asset, as they do not provide future economic benefit.

E. PPE(Asset) $3,055,000,000
   Line Costs(Expenses) $3,055,000,000
   These costs will appear under Property Plant & Equipment on the balance sheet and under expenses on the income statement.

F. Depreciation Expense $83,306,818**
   Accumulated Depreciation 83,306,818**

G: Income before taxes, as reported	$2,393,000,000
Add back depreciation for the year from part (f)	$83,306,818
Deduct line costs that were 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)

Notes: **

771000000	35045455	35045455
610000000	27727273	20795455
743000000	33772727	16886364
931000000	42318182	10579545
		83306818

Targa Company

Targa Company has decided to restructure one of its business lines. The restructuring necessitates the relocation of one of its business lines and the termination of the respective employees. On December 27, 20X1, Targa communicated its decision of a one-time, nonvoluntary termination plan: the benefit of $2.5 million is contingent upon the employees' ongoing service through the termination date; coupled with the involuntary benefit is a severance plan that amounts to $500,000 and an additional $50,000 for the facility manager.

The first issue noticed was that of the time between the date of communication and the termination date of the employees: according to the FASB Codification section 420-10-25-7, the legal notification period must be at least 60 days, and Targa Co. notification's period exceeded no more than 35 days. Also, the activities associated with the termination of the employees should be disclosed in the notes of the financial statements according to section 420-10-50-1: the disclosure should include a description of the exit activity and the details leading up to the actual exit and the one-time employee termination benefit as well as the severance plan. Targa Company should record these same activities as liabilities; according to section 420-10-25-7, the recognition of the one term benefit hinges upon whether the employees are required to serve until the termination date. If the employees are not required to render services until the termination date, the liability can be recognized on the communication date according to the FASB Codification 420-10-25-8; however, if employees are required to render services until the termination date, the liability should be recognized once at the communication date and should be recognized "ratably over the future service period" - FASB Codification 420-10-25-9. The severance plan should be recognized as a liability and then a loss upon the acceptance of the employees according to section 420-10-25-1.

In regard to the retraining and relocation costs, section 420-25-14 states that other costs associated with disposal activities include costs to consolidate facilities and move employees; furthermore section 420-25-15 states, "A liability for other costs associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred".

Merck

The purpose of this case is to hone in on equity accounts and the impact of these accounts on the financial health of Merck Company.

A. Common Shares of Merck
    a. Authorized Shares: 5,400,000,000
    b. Issued Shares: 2,172,502,884
    c. Reconciled: 29,835, 086.75
    d. Shares held in Treasury: 811,005,791
    e. Shares outstanding: 1,361,497,093
B. Companies pay dividends because shareholders have earned it. It also looks good to individuals who are interested in investing in the company
C. Why do companies repurchase their own stock?
    a. To maintain a controlling interest
    b. To increase the price of the stock
    c. To reduce the amount of outstanding
D. Retained Earnings 3,310.7

Dividends Payable 3.4

Cash 3,307.3

G. Merck repurchases its own stock

a. Cost method

b. 26. 5 million

c. 1,429.7 billion total; 53.95 for each share

d. Treasury stock is not an asset; it merely reduces equity.

I. Merck

	2007	2006
Dividends Paid	3,307,300,000.00	3,322,600,000
Shares Outstanding	811,005,791	808,437,892
Net Income	3,275,400	4,433,800
Total Assets	48,350,700	44,569,800
Operating Cash Flows	6,999,200,000	6,765,200,000
Year-End Stock Price	57.61	41.94

Xilinx

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

These plans are broad-based and have been implemented so that the company may retain its top talent and attract other top talent. They're made available to employees, consultants, non-employee directors, and to people with proprietary interest in the company. Under this plan, employees are given the option to purchase shares at 100% of the fair value on grant date. These options usually vest over 4 years. These plans help employees to be more dedicated to the success of the company, and they normally allow employees to purchase shares at a discounted price.

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

Stock options allow employees to become shareholders of the company. If the future value of the stock exceeds the current value, the holder will profit from the stock. Payment isn't required for restricted stock units, and vesting must occur before the RSU can receive its promised value. Lastly, the settlement of these can be given in stock or the cash equivalent of stock; whereas with stock options, the settlement is normally given in cash. In regard to RSUs, if the employee elects to receive stock instead of cash, he/she will become an official shareholder.

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

   i. Grant Date: The day the stock is offered/granted
   ii. Exercise Price: Price per share at which the stock/option can be sold/bought
   iii. Vesting Period: The time that an employee must wait before he/she can exercise the option
   iv. Expiration Date: The last date to exercise option
   v. Options/RSU granted: amount of options offered by company
   vi. Options exercised: the amount of options exercised by employees
   vii. Options/RSUs forfeited/cancelled: the amount of options not exercised

D. Consider the information on the employee stock purchase plan (page 63 of Xilinx's annual report). Explain, in your own words, how this plan works. What incentives does this plan provide for Xilinx employees? How do these incentives differ from the incentives created under the employee stock option and RSU plans?
    i. Qualified employees can elect to acquire a 24-month purchase right; this will allow employees to purchase stock at the end of a 6-month exercise period. This differs from the RSU plan because employees aren't given a cash option; it's similar to them both because employees who purchase this plan will inevitably become shareholders after 6 months.

E. Equity incentive plans are a type of share based payments; under these plans, companies measure the amount of employee rewards that are expected to be exercised; once the number of awards is estimated, it is then recorded as an expense to compensation over the time in which employees will perform. Coupled with recording compensation expense for an estimated amount, companies must also record compensation expense for previously granted awards that have yet to satisfy vesting requirements. Furthermore, the authoritative guidance mandates that cash flows from excess tax benefits, which are realized benefits from tax deductions, be a component of the finance section. In the case of Xilinx, the exercise price of the stock options equals the market price. Lastly, employee stock purchase plan of Xilinx is a compensatory plan and is included in compensation expense based on stock. To recognize the costs of compensation, Xilinx uses the straight-line attribution method. Deferred tax assets associated with more than one vesting date are eliminated on a FIFO basis whether the options are exercised, cancelled, or expired. The alternative transition method was used to calculate excess tax benefits.

F. Consider Xilinx's 2013 statement of income, statement of cash flows and the table on page 59 of Xilinx's annual report that discloses information about stock-based compensation expense.
    i. 77,862
    ii. Operating
    iii. Operating Section of statement of cash flows; this expense will have to be added to this section.
    iv. The income tax will be prepaid and is in the amount of 22,137.
    v. Cost of sales 6,356

R&D	37,937	
Selling, G&A	33,569	
	APIC- S/O	77,862

G. Last Gasp for Stock Options

i. Stock Options are becoming increasingly unpopular and are being replaced by restricted stock, which are more "certain" in regard to a return. Furthermore, restricted stock shares are more prevalent and represent a simpler form of compensation. In addition to the aforementioned, these shares are not subject to as many complex accounting and tax rules: Tax regulation on stock options varies from state to state but are more uniform when applied to restricted shares. Lastly, restricted shares are preferred by employees because they are worth more, have less dilution, and create less risk.
ii. The amount of options both granted and exercised align with the trends found in the article. As time progressed, the amount of RSUs granted and exercised increased; on the other hand, the amount of stock options granted and exercised decreased. For example, in 2010 the amount of RSUs granted was 3,652, and the vested amount was 1,192; in 2011, the granted amount increased to 2,977, and the vested amount increased to 1,543. On the other hand, in 2010, the amount of stock options granted was 2,345, and the amount exercised was 5,704; In 2011, the granted amount decreased to 207, and the exercised amount decreased to 3,622.

Revenue

A series of scenarios were given to explain the revenue concept. In each scenario there are five steps that can help determine when revenue should be recognized.

1. A college student walks into the Bier Haus on campus and orders a large plastic cup of beer.
    1. Identify the Contract: An agreement was made between parties when the student requested a drink.
    2. Identify the Performance Obligation: The bartender had an obligation to perform when the student handed $5.
    3. Determine the Transaction Price: The transaction price is the amount it costs to purchase a beer.
    4. Allocation Transaction Price: The beer is $5.
    5. Recognize Revenue: Revenue is recognized when the customer receives the beer.

   Cash $5

   Sales $5

2. The same student goes into the Bier Haus and orders a large beer in an Ole Miss thermal beer mug as part of a "drink on campus" campaign.
    1. Identify the Contract: An agreement was made between parties when the student returned to the bar with a mug for refills.
    2. Identify the Performance Obligation: The bartender has an obligation to perform when the student requests a refill for $7.
    3. Determine the Transaction Price: The transaction price is determined by dividing the stand-alone price of the beer and the mug by the total price. These percentages should then be multiplied by the discounted price.
    4. Allocation Transaction Price: The transaction price of the beer is approximately $4.38, and the transaction price of the mug is approximately 2.62.
    5. Recognize Revenue: Revenue is recognized when the customer receives the beer.

   Cash $7

   Mug $2.62

   Beer $4.38

3. The same student goes into the Bier Haus bringing in his beer mug and orders a large beer and a pretzel.

    1. Identify the Contract: An agreement was made between parties when the student requested a drink and a pretzel.
    2. Identify the Performance Obligation: The bartender had an obligation to perform when the student gave $7.
    3. Determine the Transaction Price: The transaction price is the price the beer and the coupon which is $7.
    4. Allocation Transaction Price: The price of the beer is 4.12, and the price of the pretzels is 2.88 ((5/8.5)*7) and ((3.5/8.5)*7).
    5. Recognize Revenue: Revenue for the beer is recognized when the beer is given; revenue for the pretzels is recognized when the coupon is redeemed.

Cash 4.12

Sales(beer) 4.12

Cash 2.88

Unearned revenue(pretzel) 2.88

4. The same student goes into the Bier Haus and orders two pretzels.

    1. Identify the Contract: An agreement was made between parties when the student requested two pretzels.
    2. Identify the Performance Obligation: The bartender had an obligation to perform when the student redeemed the coupon.
    3. Determine the Transaction Price: The transaction price is $0 since the coupon for the pretzels was previously bought.
    4. Allocation Transaction Price: $0
    5. Recognize Revenue: Revenue is recognized when the customer receives pretzels.

Unearned revenue(pretzel) 2.88

Revenue 2.88

Zagg Company

This case is defined by a series of questions related to tax differences and income. The answers to these questions highlight when income statement line items should be recorded and the relevance associated with each item.

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.
    a. Book income represents income before taxes and also may be referred to as income for financial reporting purposes and income for book purposes. The number in the statement of operation that represents this is $23,898. Taxable income is "the amount used to compute income taxes payable" and is determined by the tax code.
B. In your own words, define the following terms.
    a. Permanent Tax Differences- differences that never reverse; they may be item of book income but not items of taxable income or vice versa. An example is interest revenue on municipal bonds.
    b. Temporary Tax Difference- result from items of revenue or expense that are recognized in one period for taxable income and another period for book income.
    c. Statutory Tax Rate- the legally imposed tax rate
    d. Effective Tax Rate- the average rate at which an organization is taxed
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?
    a. A company should include deferred income taxes as part of their total income tax expense for three reasons according to the Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements":
        i. It results from a past transaction
        ii. It is a present obligation
        iii. It represents a future sacrifice
    b. Why don't companies simply report their current tax bill as their income tax expense?
        i. Because of the accrual basis of accounting, companies report current tax bills when the tax is incurred. Income tax expense includes current and deferred taxes, so reporting the current tax bill as income tax expense would not be an accurate representation of what income tax expense should be.
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.

a. Deferred income tax assets- according to the intermediate book, these taxes represent "the increase in taxes refundable in future years as a result of deductible temporary differences existing at the end of the current year". example: prepaid rent
b. Deferred income tax liabilities- - according to the intermediate book, "the deferred tax consequences attributable to taxable temporary differences". example: depreciation of an asset.

E. Explain what a deferred income tax valuation allowance is and when it should be recorded.
   a. A deferred income tax valuation allowance is used if it is more likely than not that a company will not realize some portion of all of the deferred tax asset.

F. Consider the information disclosed in Note 8 – Income Taxes to answer the following questions:
   a. Using information in the first table in Note 8, show the journal entry that ZAGG recorded for the income tax provision in fiscal 2012?
      i. Income Tax Expense 9,393

         Net DTA 8,293

         Inc Tax Pay 17,686

   b. 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. into its deferred income tax asset and deferred income tax liability components.
      i. Inc Tax Expense 9,393

         DTA 8,002

         DTL 291

         Inc Tax Pay 17,686

   c. 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?
      i. ETR: Tax Exp/Pre Tax Income

         9393/23898= 39.3%

d. 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.
    i. These amounts that total 13,508 can be found under assets.

Build-A-Bear

This case explores a variety of leases and the requirements of each by asking a series of questions.

A. Why do companies lease assets rather than buy them?
    i. Leasing allows a company to immediately use assets while paying monthly to do so; this eases the company's cash flow. Among all other things, there are tax benefits to leasing.
B. What is an operating lease? What is a capital lease? What is a direct-financing lease? What is a sales type lease?
    i. Operating lease: the term is short as compared to the useful life of the asset.
    ii. Capital lease: the lessor only finances the leased asset, and all other rights of ownership transfer to the lessee.
    iii. Direct-financing lease: the lessor removes the leased asset from its books and replaces it with a receivable.
    iv. Sales type lease: the fair value of the leased property at the start of a lease varies from its carrying amount. It involves real estate, and there is a transfer of ownership to the lessee by the end of the lease term.
C. Why do accountants distinguish between different types of leases?
    i. The accounting treatment for leases is different and should thus have two different methods. Each lease differs substantially and will ultimately impact taxes owed in different manners.
D. Consider the following hypothetical lease for a Build-A-Bear Workshop retail location.
    i. Will this lease be treated as an operating lease or a capital lease under current U.S. GAAP? Explain.
        i. This lease is an operating lease because there will be no bargain purchase option, ownership does not transfer to the lessee, and the lease term is less than 75% of the estimated economic life of the equipment.
    ii. Provide the journal entry that Build-A-Bear Workshop will record when it makes the first lease payment.
        i. Lease expense 100,000

            Cash 100,000

iii. Provide the journal entries that the company will make over the term of this lease.

I. Lease Expense 100,000
Lease Payable 25,000
Cash 125,000

*Years 2-5. The lease payable account exists as a result of the "first year free rent". The $25,000 is merely the first year's rent divided by 4 and applied to subsequent years under a payable account.

E. Consider Build-A-Bear Workshop's operating lease payments and the information in Note 10, Commitments and Contingencies. Further information about their operating leases is reported in Note 1, Description of Business and Basis of Preparation (k) Deferred Rent.
   i. What was the amount of rent expense on operating leases in fiscal 2009?
      i. According to note 10, rent expense was 45.9 million.
   ii. Where did that expense appear on the company's income statement?
      i. It is in the notes of the financial statements.

F. Criteria for Capital Lease

Period	Pmt $	PV	PV of Pmt $
1	50,651	0.9346	47337
2	47,107	0.8734	41145
3	42,345	0.8163	34566
4	35,469	0.7629	27059
5	31,319	0.7130	22330
6	25,229	0.6663	16811
7	25,229	0.6227	15711
8	25,229	0.5820	14684
			219644

   i. PPE 219,645
      i. Lease Liability 219,644
   ii. Lease Obligation 35,276
      Interest Expense 15,375
      Cash 50,651

Depreciation Expense 27,456

A/D 27,456

G. Under current U.S. GAAP, what incentives does Build-A-Bear Workshop, Inc.'s management have to structure its leases as operating leases? Comment on the effect of leasing on the quality of the company's financial reporting.
    i. As stated in letter A, there are various benefits. The main benefit is that the company's cash flow is eased. When Build-A-Bear chooses to lease equipment, expenses increase and assets will increase.
H. If Build-A-Bear had capitalized their operating leases as the FASB and IASB propose, key financial ratios would have been affected.
    i.
    ii. Refer to your solution to part f, above to compute the potential impact on the current ratio, debt-to-equity ratio (defined as total liabilities divided by stockholders' equity) and long-term debt to assets (defined as long-term debt divided by total assets) at January 2, 2010. Is it true that the decision to capitalize leases will always yield weaker liquidity and solvency ratios?

Current Ratio	1.66
Debt to Equity	0.7252
Long Term	0.1309

These numbers are representative of an operating lease. If the equipment were transferred to the books of the lessee, it would become a capital lease and would resultantly yield weaker liquidity and solvency ratios: The ratios would decrease because the liability caused by the minimum lease payments.