THE FUNDEMENTALS OF FINANCIAL ACCOUNTING: A CASE REPORT SERIES

by

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Approved by

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Abstract

This thesis is a compilation of twelve case reports completed and submitted in accordance with the alternative thesis requirements of the Sally McDonnell Barksdale Honors College. These cases were completed during the 2017-2018 school year under the direction and advising of Dr. Victoria Dickinson. These case reports are designed to align with the main topics of financial accounting and reporting covered in ACCY 303 and ACCY 304 at the University of Mississippi. Most of the case reports are from a case material publisher, while two others were created by Dr. Dickinson. The content of this thesis are my calculations, journal entries, and account tracking created in response to questions in the case related to the area of financial reporting covered by the case. Additionally, the content of these cases are my opinion, calculations and analysis and should be regarded as such.

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Glenwood Heating, Inc.
v.
Eads Heater, Inc.

Analysis and Reported Disclosed by:

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Executive Summary

The purpose of the analysis of Glenwood Heating, Inc. and Eads Heaters, Inc. was to determine the financial stability and to provide potential investors with guidance as to the safety of an investment in either company. Both companies have strong financial statements, however due to higher profitability and higher earnings per share, I have concluded that Glenwood Heating, Inc. would be a better choice for investors. There are a number of differences between the two companies that will be considered in this report. These differences will be present in the financial statements of both companies. I will begin this report with Eads Heaters, Inc.'s Profitability Analysis and financial statements followed by Glenwood Heating, Inc.'s Profitability Analysis and financial statements concluding with a comparative summary of the two companies and their financial positions and highlight differences made in the comparative summary.

Profitability Analysis of Eads Heaters, Inc.

There are a number of ratios to consider that reflect the profitability of a company, Calculations of these ratios in the chart below. The first that I will take into account is Earnings per share (EPS). Eads Heaters, Inc. has an EPS value of $22.04. This may seem like a strong position for investors, however both companies have the same number of shares and Glenwood has a higher net income than Eads resulting in higher earnings per share. Other ratios to consider are return on assets (ROA), which will indicate how effective the company is at producing income through the use of their available assets and Eads' Debt Ratio (DR). The Debt Ratio will help investors determine what kind of financial leverage Eads possesses. The higher the value of the Debt Ratio, the greater the company's financial leverage. Eads Heaters, Inc. has a ROA value of .10 or 1%. This is a rather low percentage, indicating that for every one hundred dollars that Eads has invested in its assets it generates one dollar of net income. The Debt Ratio of Eads Heaters, Inc. is .71 or 71%. This is a strong DR, indicating that Eads Heaters has a great deal of financial leverage, giving Eads the ability to use their debt to acquire more assets.

Earnings Per Share: Net Income / Total shares	EPS: $70,515 / 3200 = $22.04
Return on Assets: Net Income / Total Assets	ROA: $70,515 / $703,765 = .1 or 1%
Debt Ratio: Total Liabilities / Total Assets	DR: $496,450 / $703,765 = .71 or 71%

		Eads Heaters, Inc.				
		Classified Balance Sheet				
		December 31, 20X1				
				Assets		
Current Assets						
Cash						$7,835
Accounts Receivable				$99,400		
Less: Allowance for Doubtful Accounts				-4,970		94,430
Inventory						51,000
Total Current Assets:						$153,265
Property Plant & Equipment						
Land						$70,000
Building				$350,000		
Less: Accumulated Depreciation				-10,000		340,000
Equipment				80,000		
Less: Accumulated Depreciation				-20,000		60,000
Leased Equipment				92,000		
Less: Accumulated Depreciation				-11,500		80,500
						$550,500
Total Assets:						$703,765
			Liabilities & Stockholders' Equity			
Current liabilities						
Interest Payable						$6,650
Accounts Payable						26,440
Total Current Liabilities:						$33,090
Long-Term Liabilities						
Note Payable						$380,000
Lease Payable						83,360
Total L.T. Liabilities:						$463,360
Stockholders' Equity						
Common Stock						$160,000
Retained Earnings						47,315
Total Stockholders' Equity:						$207,315
Total Liabilities and Stockholder's Equity:						$703,765

	Eads Heaters, Inc.	
	Multistep Income Statement	
	F.Y.E. 12/31/20X1	
Net Sales		$398,500
Cost of Goods Sold		188,800
Gross Profit		$209,700
Administrative Expenses		
Depreciation Expense (Equipment)		$20,000
Depreciation Expense (Building)		10,000
Depreciation Expense (Lease)		11,500
Bad Debt Expense		4,970
Total Administrative Expenses		$46,470
Income from Operations		$163,230
Other Operating Expenses		
Interest Expense		$27,650
Operating Expense		34,200
Lease Expense		7,360
Imcome Before Taxes		$94,020
Income Tax Expense		23,505
Net Income		$70,515

	Eads Heaters, Inc			
	Statement of Retained Earnings			
	F.Y.E. 12/31/20X1			
Beginning Retained Earnin				-
Net Income				$70,515
				$70,515
Less: Dividends				$23,200
Retained Earnings				$47,315

Profitability Analysis of Glenwood Heating, Inc.

In order to maintain comparability through consistency, the same ratios will be used to determine the profitability of Glenwood Heating, Inc. that were used for Eads Heaters, Inc. As mentioned in the Profitability analysis of Eads Heaters, Inc., Glenwood Heating, Inc. has a higher EPS then Eads Heaters, Inc. Eads had an EPS of $22.04, Glenwood has a higher net income and has the same number of shares as Eads (3200 shares). Glenwood's EPS is $28.98, nearly seven dollars higher than Eads. In accordance with EPS, Glenwood's Return on Assets is also higher. Glenwood's ROA is close to four and a half percent higher at .1443 or 14.43%. Not only have these two ratios shown that the earning potential is higher for investors of Glenwood, but also that Glenwood is

more efficient with the use of their assets, generating a greater net income with less invested in assets. Lastly the Debt Ratio is taken into account. Glenwood possesses a DR of .6381 or 63.81%. While the Debt Ratio of Glenwood is slightly lower than that of Eads, Glenwood still maintains a great deal of financial leverage at 64%.

Earnings Per Share: Net Income / Total shares	EPS: $92,742 / 3200 = $28.98
Return on Assets: Net Income / Total Assets	ROA: $92,742 / $642,632 = 14.43%
Debt Ratio: Total Liabilities / Total Assets	DR: $410,090 / $642,632 = 64.81%

		Glennwood Heating, Inc.				
		Classified Balance Sheet				
		December 31, 20X1				
				Assets		
Current Assets						
Cash						$426
Accounts Receivable				$99,400		
Less: Allowance for Doubtful Accounts				-994		$98,406
Inventory						62,800
Total Current Assets:						$161,632
Property Plant & Equipment						
Land						$70,000
Building				$350,000		
Less: Accumulated Depreciation				-10,000		340,000
Equipment				80,000		
Less: Accumulated Depreciation				-9,000		71,000
						$481,000
Total Assets:						$642,632
			Liabilities & Stockholders' Equity			
Current liabilities						
Interest Payable						$6,650
Accounts Payable						26,440
Total Current Liabilities:						$33,090
Long-Term Liabilities						
Note Payable						$380,000
Total L.T. Liabilities:						$380,000
Stockholders' Equity						
Common Stock						$160,000
Retained Earnings						69,542
Total Stockholders' Equity:						$229,542
Total Liabilities and Stockholder's Equity:						$642,632

	Glenwood Heating, Inc.	
	Multistep Income Statement	
	F.Y.E. 12/31/20X1	
Net Sales		$398,500
Cost of Goods Sold		-177,000
Gross Profit		$221,500
Administrative Expenses		
Deprecation Expense (Equipment)		$9,000
Deprecation Expense (Building)		10,000
Rental Expense		16,000
Bad Debt Expense		994
Total Administrative Expenses		$35,994
Income from Operations		$185,506
Other Operating Expenses		
Interest Expense		$27,650
Operating Expense		34,200
		$61,850
Imcome Before Taxes		$123,656
Income Tax Expense		30,914
Net Income		$92,742

	Glenwood Heating, Inc.		
	Statement of Retained Earnings		
	F.Y.E. 12/31/20X1		
Beginning Retained Earnings			-
Net Income			$92,742
			$92,742
Less: Dividends			-$23,200
Retained Earnings			$69,542

Comparative Summary

There are three key factors to consider when analyzing the financial statements of Eads Heaters, Inc. and Glenwood Heating, Inc., inventory, recognition of bad debts and depreciation expense. Glenwood's inventory was calculated using the FIFO method and Eads followed the LIFO method. The difference in methods resulted in a higher cost of goods sold for Eads by 11,800, thus driving down Eads gross profit, eventually leading to a lower net income. This difference is illustrated below.

	Glenwood Heating, Inc.		
	Multistep Income Statement		
	F.Y.E. 12/31/20X1		
Net Sales			$398,500
Cost of Goods Sold			-177,000
Gross Profit			$221,500

	Eads Heaters, Inc.	
	Multistep Income Statement	
	F.Y.E. 12/31/20X1	
Net Sales		$398,500
Cost of Goods Sold		188,800
Gross Profit		$209,700

The second factor that must be brought into consideration is how the companies differed in the percentage of uncollected receivables they recognized. Glenwood determined their estimation of bad debt would be 1% whereas Eads estimated theirs to be 5%. This seemingly small difference has a large impact on the balance in the factoring of the current assets. Both companies had the same amount of accounts receivable, but Eads choosing to recognize 5% in comparison to Glenwood's 1% resulted in a $3,796 difference in the two companies Allowance for Doubtful Accounts. This difference is illustrated below.

	Eads Heaters, Inc.			
	Classified Balance Sheet			
	December 31, 20X1			
		Assets		
Current Assets				
Cash				$7,835
Accounts Receivable		$99,400		
Less: Allowance for Doubtful Accounts		-4,970		94,430
Inventory				51,000
Total Current Assets:				$153,265

		Glennwood Heating, Inc.				
		Classified Balance Sheet				
		December 31, 20X1				
				Assets		
Current Assets						
Cash						$426
Accounts Receivable				$99,400		
Less: Allowance for Doubtful Accounts				-994		$98,406
Inventory						62,800
Total Current Assets:						$161,632

The final factor considered is depreciation expense amounts of the two companies, especially when looking more closely at the depreciation methods used for the delivery equipment. Both companies used the Straight-line depreciation method for calculating depreciation on their buildings, however they differed with the methods used for the delivery equipment. Eads did not use the Straight-line method like Glenwood did, but instead used the Double Declining balance method. The difference in methods used resulted in an $11,000 difference in the amount of depreciation expense paid on the delivery equipment for Eads. Eads also more in accumulated depreciation on a large piece equipment they leased. Glenwood did not recognize depreciation on the same large piece of equipment because they chose to rent the equipment instead of forming a long-term lease. Both sets of differences are illustrated below.

Delivery Equipment differences

Eads Heaters, Inc.

Administrative Expenses		
Depreciation Expense (Equipment)		$20,000
Depreciation Expense (Building)		10,000
Depreciation Expense (Lease)		11,500
Bad Debt Expense		4,970
Total Administrative Expenses		$46,470

Glenwood Heating, Inc.

Administrative Expenses		
Deprecation Expense (Equipment)		$9,000
Deprecation Expense (Building)		10,000
Rental Expense		16,000
Bad Debt Expense		994
Total Administrative Expenses		$35,994

Lease Differences

Eads Heaters, Inc.

Property Plant & Equipment				
Land				$70,000
Building	$350,000			
Less: Accumulated Depreciation	-10,000		340,000	
Equipment	80,000			
Less: Accumulated Depreciation	-20,000		60,000	
Leased Equipment	92,000			
Less: Accumulated Depreciation	-11,500		80,500	
			$550,500	

Glenwood Heating, Inc.

Property Plant & Equipment						
Land						$70,000
Building				$350,000		
Less: Accumulated Depreciation				-10,000		340,000
Equipment				80,000		
Less: Accumulated Depreciation				-9,000		71,000
						$481,000

Conclusion

In closing I reassert my statement that Glenwood Heating, Inc. is a stronger choice for investors due to not only to the EPS being significantly higher, but also Glenwood's ROA being significantly higher as well. The differences in these two company's may be due to some differing accounting practices that have been highlighted in the comparison summary. While the two companies do not account for some things in the same manner, the purpose of this case study was to provide insight to interested parties as to which company would be a better choice for investment. Taking the Debt Ratio into consideration allowed potential creditors to see the amount of risk taken on by each company. As before with the EPS and ROA, Glenwood possessing a lower Debt Ratio level will show potential creditors that they have taken on less risk and is a more attractive offer.

Analysis of Profitability and Earnings Persistence of Molson Coors Brewing Company

Specifically

Income Statement Classification

Special Items

Comprehensive Income

Effective Tax Rate

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

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Executive Summary

Molson Coors is a publicly traded company headquartered in Denver Colorado. The Purpose of this case was to investigate the classification of Molson Coors brewing company. The classification of the income statement of Molson Coors is separated into several sections. There are two major sections of the income statement, the operating section and nonoperating section. These major sections are broken into the he Revenues, Expenses and Gains and Losses.

A. The Major Classifications of the Income statement are Revenues, Expenses, Gains and Losses. The income statement can be further classified into a number of sections.

Operating Section - The report of revenues from the company's main operations

a. Revenues (Sales) - Sales, Discounts, Allowances, Returns. The Purpose of this section is to determine the net amount of sales revenue.
b. Cost of Goods Sold - The monetary amount of inventory sold to produce the revenues presented in the subsection above.
c. Selling Expenses – Expenses directly associated with the sales of the company
d. Administrative & General Expenses - Expenses associated with the administrative positions of the company.

Non-Operating Section - The report of revenues and expenses resulting from auxiliary activities of the company

a. Other Revenues & Gains - Revenues recognized or incurred gains from non-operating transactions.
b. Other Expenses & Losses - Expenses or losses incurred from non-operating transactions

Income Tax - The section reporting taxes levied on income from operations. (State and Federal Taxes)

Discontinued Operations - Gains or losses reported from business units that have been discontinued in a company. Must be material to be reported

Non-controlling Interests - Income allocated that will be distributed to non-controlling shareholders.

Earnings Per Share (EPS) - Generally defined as Net Income divided by outstanding
shares. This can be used to measure the performance of a company over a reporting period.

B. Under U.S. GAPP companies are required to provide Classified Income Statements for the purpose of full disclosure or providing enough detail to properly disclose material business activities, but remaining condensed enough to keep information understandable. The understandability principle can be cited as providing information that is understandable by an individual with reasonable knowledge of the contents of the financial statements under review.

C. Financial statement users are generally investors and creditors. Taking that into account, users of financial statements would be concerned with predictability of future earnings. Persistent income that is found to be consistent within the company and comparable to others in the market can provide users with information that may impact their investment or lending decisions.

D. Comprehensive income can be defined as a change in equity of an entity during a period resulting from events and circumstances from non-owner sources. These events and circumstances can be the result of unrealized holdings, gains or losses. Comprehensive income differs from net income in the areas of unrealized holdings, gains or losses and investments, net Income does include these items. In addition, comprehensive income does not include changes in equity resulting from investments from owners or distributions to owners.

E. The purpose of reporting Sales and Net Sales separately is to show that an excise tax has been levied on the product. In this case an excise tax on alcohol. Both Federal and State excise taxes may be levied on Molson Coors product.

F. Molson Coors defines special items in note 1 as “charges incurred or benefits realized that we do not believe to be indicative of our core operations; specifically, such items that are considered to be:

    i. Infrequent or unusual items, impairment or asset abandonment-related losses, restructuring charges, atypical employee related costs or termination fees on significant operating agreements and gains or losses on disposal of investments.

       In the case of Molson Coors examples of these items are impairments of intangible assets, flood loss, costs associated with outsourcing, costs associated with strategic initiatives.

    ii. Special items are reported on separate line in order to provide investors with the ability to compare across periods on gains or losses that do not usually occur as part of the company’s operating activities.
       I concur with this classification, because if these items are listed with other losses or gains items and not classified as unusual or infrequent it could impact investors decisions due to a misrepresentation of income.

G. Other income (expenses), net holds distinction from Special Items because special items are considered to be part of operating activities while Other income (expenses is considered to not be a part of normal operating activities of the business.

H. Comprehensive Income

i. Comprehensive Income in 2013: $760.2 Million
Net Income in 2013: $567.3 Million

ii. The difference between net income and comprehensive income is the unrealized gains and losses from the inclusion of special items in comprehensive income. The largest of which came from "Pension and other Postretirement benefit adjustments" for 240.7 million.

J. Effective Tax rate

i. The Effective Tax rate in 2013: 12.8%
This lower tax rate can be accounted for by discounts provided by operations in foreign countries.

Analysis of Accounts Receivables and Provision for Bad and Doubtful debts
Pearson – PLC

Specifically

The Appearance and Calculation of

Accounts/Trade Receivables, Bad/Doubtful debts

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

I have a number of takeaways from this case, the first of which is a greater understanding of accounts receivables. I learned more about not only the various names that are used for account receivables, but also the appearance and the reporting practices of receivables in the financial statements. In addition to accounts receivables, this case broadened my understanding of the reporting practices of bad and doubtful debts as well as sales returns. Lastly this case provided me with exposure as to the terminology differences in accounting between U.S. GAAP and the accounting practices of the United Kingdom. This exposure was due to Pearson-PLC's base of operations being located in the U.K.

A. An account receivable is an outstanding loan/sale on credit to a customer. This account represents the credit between a buyer and seller or a customer and a service provider. Accounts receivable provides an advantage by allowing a transaction to occur without payment at the time of the transaction. In a very basic sense an account receivable is an IOU. Accounts receivable may be identified by a few names such as trade receivables, receivables, loans, IOU's and in a physical sense an unpaid invoice can be considered a representation of an outstanding account receivable.

B. Notes receivables and accounts receivables differ in a number of ways. The most prominent of these differences is that a note receivable is generally designed to account for money loaned from one business entity to a person or other business entity. In addition to this, a note receivable is designed to be paid back (in most cases with interest) at a certain date. An account receivable is less structured in terms of when it must be paid and is the repayment of the amount (unless there is a penalty for late payment) represented in the transaction. Notes receivables are mainly affiliated with financial institutions, whereas accounts receivables are set up from nearly every business transaction today's economy

C. A contra account reduces the account it is associated with. Such as a contra-asset account reduces the normal debit balance of an asset account. In the case of a liability a contra-liability account will reduce the normal credit balance of a liability account. Contra accounts generally come about when there is a cross-reference on the balance sheet. A cross-reference is a direct relationship on the balance sheet between an asset and a liability.

   The two accounts associated with Pearson's trade receivables are Allowance (Provision*) for bad and doubtful debts and Allowance (Provision*) for sales returns.
   These accounts are linked to the activities of the reconciliation of not receiving payment on trade receivables (Allowance for bad/doubtful debts) and the return of inventory by customers (Allowance for sales returns).

   There are a number of factors that management should consider when estimating the balances of these accounts. Understanding a customer's usual payment style. Do they pay late, on time or early? When considering larger companies with many customers factors such as the age of the receivable, percentage of accounts outstanding and how many sales were made on credit.

D. The two most common approaches for estimating accounts receivables are the percentage-of-sales procedure and the aging-of-accounts procedure.

   The percentage-of-sales approach is established on the assertion that the amount of bad debt is based upon a measure of sales. This measure of sales may

be either total sales or total sales made on credit. Using previous year's results as well as customer information, a company can reasonably estimate what percentage of sales they believe will be uncollectable. This method can be applied by taking either the number of total sales or all sales made on credit and multiplying it by the estimated percentage of sales that are believed to become bad debt. Additional Information Provided in Appendix A

The aging-of-accounts approach is a blend of the percentage of receivables approach that includes the age/length of time outstanding of the receivables. The longer that a receivable has been left outstanding the lower the chances are that the account will be paid. The aging-of-accounts method assigns a percentage to determine the amount uncollectible in receivables based upon the length of time they have been outstanding. As previously mentioned, the greater the length of time that the receivables have been outstanding, the greater the percentage that those balances will not be collected. Information regarding the calculation of the aging-of-accounts approach can be found in appendix A.

Of the two approaches, I believe that the aging-of-accounts method is a more accurate estimate of bad debts because it considers the length of time that the receivable has been outstanding. Given that the longer the length of time that a receivable has been outstanding the less likely it is to be paid, indicates that taking the length of time outstanding into account more accurately determines bad debt expense.

E. It is a conservative management practice to assume that some accounts will not be paid either on time, in full or at all. That being said, management will enter into a contract to provide a service or product to a customer or business under the assumption that they will be paid for what they have provided. However, with cash flow being such an important factor in the success of a business, management must determine what customers are worth keeping and those of which who are not. If a customer is perpetual in late payment, not paying in full or nor paying at all, it may be in the best interest of the company to remove that customer and seek to replace them with one that will pay.

F. The below was found and calculated using the information in Note 22
   i. *Use the information in Note 22 to complete a T-account that shows the activity in the *provision for bad and doubtful debts account during the year. Explain, in your own words, the line items that reconcile the change in account during 2009.*

Provision* for Bad and Doubtful Debts (T-Chart 1)

72,000	
5,000	26,000
20,000	3,000
£76,000	

Amounts in thousands

(Description of monetary values** available in Appendix B T-Charts 1-3)

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

Bad and doubtful debt expense

Bad Debt Expense	£26,000,000	
Provision* for Bad and Doubtful Debts		£26,000,000

Write-off of Bad debts (Utilized Amnt.)

Provision for Bad Debts and Doubtful Accounts	£20,000,000	
Accounts Receivables		£20,000,000

Bad debt Expense – Income statement
Provision* for bad and Doubtful Debts – Balance sheet
Accounts Receivable – Balance sheet

iii. Provision* for bad and doubtful debts occur as a result of Pearson's main operating activities therefore it is found in the operating section of the income statement. Provisions* for bad and doubtful debts is deducted from gross sales to calculate net sales.

G. *Note 22 reports that the balance in Pearson's provision for sales returns was £372 at December 31, 2008 and £354 at December 31, 2009. Under U.S. GAAP, this contra account is typically referred to as an "allowance" and reflects the company's anticipated sales returns.*

i. *Complete a T-account that shows the activity in the provision for sales returns account during the year. Assume that Pearson estimated that returns relating to 2009 Sales to be £425 million. In reconciling the*

change in the account, two types of journal entries are required, one to record the estimated sales returns for the period and one to record the amount of actual book returns.

Provision for Sales Returns (T-Chart 2)	
	£372,000
	£425,000
£443,000	
	£353,000

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

Estimated Sales Returns (2009)

Sales		£425,000,000
	Provision* for Sales Returns	£425,000,000

Actual Returns (2009)

Provision* for Sales Returns		£443,000,000
	Accounts Receivables	£443,000,000

Provision* for Sales Returns – Balance Sheet
Sales – Income Statement Account
Accounts Receivables – Balance Sheet

iii. Similarly, to Provision* for bad and doubtful debts, Provision* for Sales returns is a result of Pearson's main operations and is reported in the operating section of the income statement. Provision for Sales returns will be

H. *Create a T-account for total or gross trade receivables (that is, trade receivables before deducting the provision for bad and doubtful debts and the provision for sales returns). Analyze the change in this T-account between December 31, 2008 and 2009. (Hint: your solution to parts f and g will be useful here). Assume that all sales in 2009 were on account. That is, they are all "credit sales." You may also assume that there were no changes to the account due to business combinations or foreign exchange rate changes. Prepare the journal entries to record the sales on account and accounts receivable collection activity in this account during the year.*

(Gross) Trades Receivables (T-Chart 3)	
£1,030,000	
5,624,000	
	5,202,000
	20,000
	443,000
£989,000	

Amounts with thousands

Entries

Sales on Account
Accounts Receivable £5,624,000,000
Sales 5,624,000,000

Cash £5,202,000,000
Accounts Receivables £5,202,000,000

Accounts Receivables Collection
Provision* for Bad and Doubtful Debts £20,000,000
Accounts Receivable £20,000,000

Provision* for Sales Returns £443,000,000
Accounts Receivable £443,000,000

Appendix A:

* Provision is the United Kingdom's term for allowance
Pearson is based out of the U.K. so there is some translation of terminology.

The Percentage of sales approach of Bad Debt can be calculated and journalized using the following information.

Sales x Estimation of uncollectable sales = Bad debt expense

Entry: Bad Debt Expense
Allowance for Doubtful Accounts

Aging-of-accounts method can be calculated by taking the estimation of receivables outstanding that based upon the amount of time they have been outstanding. Such as: 1-30 days outstanding = 2% uncollectible; 31-60 days outstanding = 6%; and so on.
This estimation is then multiplied by the balance of receivables in each given time frame.

Bal. Receivables (31-60 days) x 6% = Estimated of amount uncollectable

Entry: Bad Debt Expense
Allowance for Doubtful Accounts

The entry above is the difference adjusted and unadjusted amounts in bad debt expense

Appendix B:

** Note: All monetary values are presented in Euro's

T-Chart 1 Provision* for Bad and Doubtful Debts
Credit Side

Provision/Allowance for Bad and Doubtful Debts
£72,000,000 (Beginning balance 2009/ Ending Balance in 2008)

Income Statement Movements
£26,000,000 (During 2009)

Acquisitions (Translation of bad debts)
£3,000,000 (During 2009)

Ending balance 2009
£76,000,000

Debit Side

Exchange Differences
£5,000,000 (During 2009)

Utilized (Bad debt actually incurred)
£20,000,000 (During 2009)

T-Chart 2 Provision for Sales Returns
Credit Side

Provision/Allowance for Sales Returns
£372,000,000 (Beginning balance 2009/ Ending Balance in 2008)

Estimation of Sales Returns
£425,000,000

Debit Side

Actual Amount of sales Returns for 2009
£443,000,000

Ending Balance 2009
£353,000,000

Appendix B Ct'd

T-Chart 3
Debit Side

Gross Trades Receivables (End. Bal. 2008/ Beg. Bal. 2009)
£1,030,000,000

Sales made on credit (During 2009)
£5,624,000,000

Ending Balance (End. 2009)
£989,000,000

Credit side

Cash Collected from Sales
5,202,000,000

Utilized (Bad debt Write off)
£20,000,000

Provision/Allowance for Sales Returns
£ 443,000,0000

Special Assignment: Area of Difficulty

ACCY 303

Specifically

Time Value of Money Concept and Computation

Analysis and Report Disclosed by

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

The purpose of this special assignment is to bolster, through a narrative and computational presentation, an area of ACCY 303 that I found challenging. The area I chose was the time value of money. In basic terms the time value of money is a concept that addresses how a dollar today is worth more in the future. I believe that this case did in fact bolster my understanding of the time value of money by being asked to present and describe the individual steps of a time value of money problem from the ACCY 303 textbook.

Time Value of Money

The objective of this case is to identify a topic in Intermediate 1 (ACCY 303) that I find difficult. To complete this case, I will work through and explain a problem related to this topic in such a way to aid a fellow accounting student who is also challenged by this concept.

Problem 6-2 (pg. 306 of Intermediate Accounting 16 edition Wiley)
This Problem presents multiple situations in which the concept of The Time Value of Money represented. The Problem is broken down into 4 unique situations (a.- d.), a. and b. are presented below with annotation of the steps needed to calculate their answers.

P6-2.) "*Use the appropriate interest table, provide the solution to each of the following four questions by computing the unknowns.*"

(a.) *What is the amount of the payments that Ned Winslow must make at the end of each 8 years to accumulate a fund of $90,000 by the end of the eighth year, if the fund earns 8% interest, compounded annually?*

Step 1: Determine whether this is a Single Sum or Annuity Problem:

This particular problem is an Annuity problem, we are able to determine this by seeing that we will be calculating the amount of payments N. Winslow will be making at the end of each year.

Step 2: Determine whether this is a Present or Future value annuity and whether it is an annuity due or ordinary annuity:

The text of the problem states, "…payments that Ned Winslow must make at the end of the year…" that statement tells us that this is an Ordinary annuity problem. Ordinary annuities can be identified this way because their cash flows come at the end the period. To determine whether it is a present or future value annuity, we must realize that we are looking to determine how much these payments will accumulate to in the future. In this problem, we want them to accumulate to $90,000.

Step 3: Calculation

Since we have already determined that this is a future value ordinary annuity. We will use a present value annuity due table to aid us in this calculation.

Future Value - Ordinary Annuity = 90,000
R = Annual Payment (What we will be calculating)
FVF – OA (8,8%) – future value factor of an ordinary annuity of 8 period and 8% interest. Found in table 6-3

FV – OA = R(FVF-OA 8,8%)

90,000 = R(10.63663)

Divide

(90,000) / (10.63663) = R

R = $8,461.33, Therefore Ned Winslow's annual payment is equal to $8,461.33.

(b.) *Robert Hitchcock is 40 years old today and he wishes to accumulate $500,000 by his 65th birthday so he can retire to his summer place on lake Hopatcong. He wishes to accumulate this amount by making equal deposits on his 40th – 64th birthdays. What annual deposit must Robert make if the fund will earn 8% interest compounded annually?*

Step 1: Determine whether this is a Single Sum or Annuity Problem:

This particular problem is an annuity problem, we are able to determine this by seeing that we will be calculating the amount of payments that Mr. Hitchcock will be making annually.

Step 2: Determine whether this is a Present or Future value annuity and whether it is an annuity due or ordinary annuity:

Since we wish to determine the annual deposits that with the given interest over the next 25 years will accumulate to $500,000, we can determine that this is a future value ordinary due problem. The difference in an annuity due and an ordinary annuity is that the first withdrawal of this accumulation is at the same date of the last deposit.

Step 3: Calculation

Now that we have determined that this is a Future value annuity due problem we can began calculation of the value of the annual payments Mr. Hitchcock will make over the next 25 years on his birthday. We will first begin to calculate this as ordinary annuity, however to determine the future value factor of an annuity due we must multiply the future value factor of an ordinary annuity of our given criteria by 1.08 (One Plus the interest rate.)

Future Value – Ordinary Annuity = 90,000
R = Annual Payment (What we will be calculating)
FVF – OA (25,8%%) – future value factor of an ordinary annuity for 25 periods with 8% interest

FV – OA = R(FVF-OA25,8%)

FVF – OA 25,8% = 73.10594 x 1.08 = 78.95442 -> FVF – AD 25,8%

500,000 = R(78.95442)

Divide

(500,000) / (78.95442) = R

R = 6,332.77, The annual payments for Mr. Hitchcock made on his birthday for the next 25 years with the 8% interest will be $6,332.77.

Conclusion

These two examples of the time value of money present the Future value of ordinary due and future value of an ordinary annuity. Both of these examples are very common in both business situations as well as personal financial situations. The two examples presented above represent personal financial situations. The process of learning this information has broadened the scope of my knowledge of not only accounting, but also personal finance tactics I can use at a young age to accumulate savings.

Analysis and Reporting of Depreciable Assets and Fixed Cost Items

Palfinger, AG

Specifically

Property, Plant and Equipment

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

In the analysis of Palfinger AG, a German manufacturer of industrial hydraulic lifting, handling and loading equipment, I learned on a more specific level the accounting techniques for recording property, plant and equipment as well as recording the effect depreciation has on property, plant and equipment. Palfinger, a manufacturer has many fixed assets that depreciate over the course of their useful life, in order to properly account for the depreciation of these assets, depreciation schedules must be formed to track the accumulation of the depreciation expense for each asset. Both the methods of straight-line depreciation and double declining balance were used to track the accumulation of depreciation of an addition listed as "fixtures, fittings, and equipment." From applying these different methods, I was able to observe the difference in the value, as well as the length of useful life each method enables the asset to have. Along with calculating the depreciation schedules for a fixed asset, this case required the calculation of a gain and a loss through the sale of the asset "fixtures, fittings and equipment," that the depreciation schedules were calculated for. The results of the differences in the depreciation methods led to gain on the sale of the asset when the double declining balance was used and a loss on the sale of equipment when the straight-line method was used. These differing methods present impact that differing accounting methods can have on the income statement.

A. Palfinger AG is a manufacturer of hydraulic loading, lifting and handling machinery that is sold worldwide. Palfinger manufactures cranes, forklifts, front-end loaders, as well as work platforms and railway equipment. You could expect to find Palfinger machinery on any mid-size to large construction sites. In order to construct equipment of this strength and size, Palfinger has large buildings for

assembly and machine work in addition to lifting systems of their own to move these large machine parts through each stage of the manufacturing process. Palfinger is a global leader in this industry and is using the leading robotics technology used in many automobile manufacturing plants.

B. €149,990 (thousands of Euro's) represents the value of the value of Palfinger's property, plant and equipment after accumulated depreciation has been accounted for using the straight-line method. Property such as buildings or investments in third party building are depreciated over the course of 8-50 years, plant and machinery is depreciated over 3-15 years and fixtures, fittings and equipment are depreciated over 3-10 years. Fixed assets that expected to be sold in the market are not depreciated, instead these assets, if necessary are written down to their net realizable value less costs to sell.

C. Palfinger reports several types of equipment in the notes of their financial statements. The assets reported deviate from what may be usually thought of as equipment. Palfinger has their own buildings as well as buildings owned by a third party in which Palfinger has an investment. These types of assets are expected to have a useful life of 8-50 years. Plant and machinery are also reported in the financial statements of Palfinger and are estimated to have a useful life of 3-15 years. Lastly Palfinger reports fixtures, fittings and equipment in the financial statements. The group of fixtures, fittings and equipment is comprised of appliances, computer systems, electronic equipment, office furniture and other similar items that have no permanent connection to the structure and/or utilities of the building. Fixtures, fittings and equipment have a useful life ranging from 3-10 years.

D. "Prepayment and assets under construction" represents the completion of construction a building or the construction the building is put under to make it ready for use. This process could range from demolition or additions and refurbishment to get the building up to date with modern features and fixtures. Accumulated depreciation is not taken into account because the building is not in use yet, therefore it has not begun its useful life. The €14,958 has been reclassified from the clearing account of "Prepayments and assets under construction" and moving into Property, plant and equipment because the assets that comprise that amount have been completed and are ready for use.

E. Palfinger uses the straight-line depreciation method to calculate the depreciation of its assets. This method is bases deprecation as a function of time and not a function of usage. This depreciation method is a good choice for Palfinger's facilities because the buildings are under similar weather and usage patterns from year to year. However, in the case of the manufacturing equipment it may be more accurate to determine the value of the equipment using a method that takes the usage of the equipment into account.

F. Value-enhancing modifications such as refurbishment of buildings and maintenance of equipment are capitalized and depreciated either over the original useful life or the new useful life based on how much value is added by the modifications. There are alternative accounting treatments for this, the substitution approach and a charge to accumulated depreciation. The substitution is most accurate if the carrying value of the asset prior to the refurbishment or enhancement is available. A charge to accumulated depreciation is in order if the enhancement or modification does not improve the asset itself but instead, extends the asset's useful life.

G. Use the information in the financial statement notes to analyze the activity in the "Property, plant and equipment" and "Accumulated depreciation and impairment" accounts for 2007. Determine the following amounts:

Note: All values are provided in thousands of Euro's (Teur)

i. The amount for the purchase of new property, plant and equipment is €40,444. This value was determined by taking the total of the additions row at acquisition cost (€61,444) and subtracting the prepayments and assets under construction (€21,000). The prepayments were subtracted because they pertained assets under construction which are not ready for use.

€61,444 - €21,000 = €40,444

ii. (€733) is the total amount of government subsidy provided to Palfinger in the form of grants by the governing body. This amount is formulated by the addition of a €417 subsidy for land and buildings and a €316 subsidy for plant and machinery. Government grants can be given to businesses in many forms. The most popular form is in the form of an asset, such as, cash, securities, and property, plant and equipment. These assets are provided in the form of a subsidy to the company. In the case of Palfinger AG the governing body is providing these grants on the basis of subsidizing Palfinger to promote their growth and contribution to the national and global economy.

€417 + €316 = €733

iii. €12,557 is the depreciation expense amount of the fiscal year 2007, excluding write-up's, disposals and additional capitalization. €12,557 is calculated by the accumulation of a €2,826 depreciation expense for land and buildings, a €6,869 depreciation expense for

plant and machinery and a €2,862 depreciation expense for other plant, fixtures, fittings and equipment.

€2,826 + €6,869 + €2,862 = €12,557

iv. The acquisition cost less accumulated depreciation is method to determine the net book value of an asset. Palfinger's acquisition cost of Property, plant and equipment for 2007 has a book value of €177,363. To determine the net book value of Palfinger's property, plant and Equipment in 2007, the accumulated depreciation of property, plant and equipment for 2007 must be subtracted from the 2007 book value of property, plant and equipment. The book value of the accumulated depreciation for property, plant and equipment in 2007 is €12,577. The net book value is calculated below.

€177,363 - €12,557 = €164,806

H. When a gain or loss occurs in the sales of property, plant and equipment it means that the amount of cash received is greater than (gain) or less than (loss) than the book value of that particular asset. The book value of Palfinger's property, plant and equipment recorded in 2007 is €164,806. If the net gain from the sale of property, plant and equipment totaled to €1,655, then it can be reasonably concluded that the gain from the sale of equipment increased the 2007 book value of Palfinger's property, plant and equipment assets by €1,655.

I. *Consider the €10,673 added to "Other plant, fixtures, fittings, and equipment" during fiscal 2007. Assume that these net assets have an expected useful life of five years and a salvage value of €1,273. Prepare a table showing the depreciation expense and net book value of this equipment over its expected life assuming that Palfinger recorded a full year of depreciation in 2007 and the company uses:*

i. Straight-line depreciation.

ii. Double-declining-balance depreciation.

i. In order to calculate the depreciation schedule using the straight-line depreciation method you must subtract the estimated salvage value from the original purchase cost of the asset to get the carrying value of the asset. Next the divide 1 by the number of years of useful life to determine the depreciation rate. Once the carrying value and the depreciation rate has been determined, multiply the depreciation rate by the carrying value to determine the depreciation expense for that year. The new carrying value for each year can be calculate by subtracting the depreciation expense for that

year from the beginning carrying value of the year in calculation. Calculations and schedule are shown on the following page:

Carrying value of additions: €10,673 - €1,273 = €9,400
Depreciation rate of additions: 1 / 5 years = 20%

Straight-Line Depreciation Schedule

Year	Beginning Carrying Value	Depreciation expense (Rate: 20%)	Ending Carrying Value	Accumulated Depreciation
2007	€9,400	€1,880	€7,520	€1,880
2008	€7,520	€1,880	€5,640	€3,760
2009	€5,640	€1,880	€3,760	€5,640
2010	€3,760	€1,880	€3,850.24	€7,520
2011	€1,880	€1,880	€0	€9,400

ii. When calculating the depreciation schedule using the double declining balance you must first determine the book value, or original acquisition price of the asset that is being decrepitated, in this case it is €10,673. Since we have already determined the depreciation rate of 20% for the straight-line depreciation method, we may simply double that rate so it can be used for the double-declining balance method. The value calculated by multiplying the depreciation rate times the beginning book value for that year will yield the depreciation expense for that year. Subtracting the depreciation expense for the year from the beginning book value of that year will providing the book value of the asset at year end.

Book value of addition: €10,673
Depreciation rate of additions: 1/5 = 20% x 2 = 40%

Double Declining Balance Depreciation schedule

Year	Beginning book Value	Depreciation Expense (Rate: 40%)	Ending Book Value (Net)	Accumulated Depreciation
2007	€10,673.00	€4,269.20	€6,403.80	€4,269.20
2008	€6,403.80	€2,561.52	€3,842.28	€6,830.72
2009	€3,842.28	€1,536.91	€2,305.37	€9,136.09
2010	€2,305.37	€922.15	€1,383.22	€10,058.24
2011	€1,383.22	€110.22*	€1,273	€10,168.46

* An adjustment is made in order for the asset not be depreciated beyond its salvage

value. If this adjustment was not made the depreciation expense for 2011 would have been €553.29, and the ending book value would have been €829.93, €443.07 under the salvage value.

J. *Assume that the equipment from part i. was sold on the first day of fiscal 2008 for proceeds of €7,500. Assume that Palfinger's accounting policy is to take no depreciation in the year of sale.*

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

Entries from the sale of the equipment:

Depreciation Expense	€1,880	
Accumulated Depreciation		€1,880

(To record the depreciation for the period of time from the last deprecation entry and the date of sale.)

Cash	€7,500	
Accumulated Depreciation	€1,880	
Loss – Equipment sale	€893	
Equipment		€10,273

(To record the sale of the Equipment. A loss occurred because the acquisition cost of the equipment was greater than that of cash received plus the accumulated depreciation of the equipment from the period prior to sale.) Loss: (€10,273 – €7,500 + €1,880 = €893)

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

Depreciation Expense	€4,269.20	
Accumulated Depreciation		€4,269.20

(To record the depreciation for the period of time from the last

depreciation entry and the date of the sale.)

Cash	€7,500	
Accumulated Depreciation	€4,269.20	
Equipment		€10,273
Gain – Equipment Sale		€1,496.20

(To record the sale of equipment. A loss occurred because the acquisition cost of the equipment was less than the sum of the cash received from the sale and the accumulated depreciation of the equipment leading up to the date of the sale.)
Gain: (€10,273 – €7,500 + €4,269.20 = - €1,496,20)

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

The income statement impact of the loss on sale of equipment shown above in part i. is similar to that of an expense. The loss on the sale of the equipment will reduce net income by the amount of the loss (€893).

Conversely, the income statement impact of the gain realized from the sale of equipment in part ii. will increase net income in the same way that a revenue would by the amount of the gain (€1,496.20).

Analysis and Reporting of Research & Development Costs and internally generated assets

Volvo Group

Specifically

The reporting of Amortization from Intangible Assets

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

Volvo Group, a commercial supplier of large equipment such as trucks, busses and construction equipment invests a great deal of capital into research and development to meet the needs environmental laws and regulations. Accounting for research and development expenditures requires a great deal analysis in order to determine whether expenditures can be capitalized or if they should be expensed when incurred. Throughout the study of Volvo, I learned on a more in-depth level how this accounting takes place. To begin this process, research and development expenditures must pass a set of criteria provided in IAS 38 (Volvo Group is based out of Sweden and follows IFRS). These criteria determine whether the expenditures related to research and development can be classified as an intangible asset, these assets can be capitalized and then amortized over the course of their useful life. If the expenditure does not fit the criteria in IAS 38 then it will be expensed at its acquisition cost in the period that the cost was incurred. After expenditures have been determined to be expensed or recorded as intangibles, the intangible assets will be evaluated to determine how they should be amortized. There are a number of ways that amortization of intangible assets can take place. The amortization of intangibles assets may take place in on the basis of the straight-line method if the useful life can be reliably determined, in cases in which the useful life cannot be determined reliably, methods such as a pattern of benefits method may be used. In other circumstances when neither a useful life or pattern of benefits cannot be reliably determined, a revenue based approach or a systematic

method that takes into account acquisition cost of the asset and its residual value after use, can be implemented.

A. Listed on Volvo's income statement is an expense amount for research and development of SEK 13,193 (in millions of Swedish Krona). This amount includes the costs incurred from, but is not limited to, activities aimed to obtain new knowledge, the search for alternatives for materials, devices, processes, systems or services. More specifically, costs linked to product discovery and development, such as patents, raw materials, prototype testing, design and engineering and market research. These are included in research and development expenditures on the basis that these activities do not include routine or periodic alterations to existing product lines, manufacturing processes and ongoing operations. Research and development expenses are treated by Volvo as intangible assets. This is contingent on whether the expenditures can be believed to have a high level of certainty that they will provide future financial benefits. In order for development expenditures to be reported as assets, the expenditures must meet some criteria; e.g. it must be possible to prove the technical functionality of a new product or software prior to its development being reported as an asset.

B. Volvo group considers a number of factors when deciding which research and development costs to capitalize and which to expense. In order for these expenses to be capitalized the must first be recognized as an intangible asset, secondly in order for the asset to be capitalized it must be in the industrialization phase of the development process. Only processes, systems, services etc. can be capitalized if they have met the criteria listed in IAS 38 part 57. These criteria include, but are not limited to, the "Technical feasibility of completing the intangible asset so that it will be available for use or sale," "its ability to use or sell the intangible asset," "its ability to measure reliably the expenditure attributable to the intangible asset during its development." If the internally generated expenditure has not met the criteria listed in IAS 38 part 57 then it will be expensed at cost when it is occurred. If the research phase is not distinguishable from the development stage on a certain internal project, then the expenditures related to that project will be treated as if they were incurred during the research phase.

C. In determining amortization period for internally generated intangible assets, Volvo group uses measurement guidelines provided IAS 38. If an asset has a finite life, then it will be amortized over that determined lifespan using the straight-line method. If an asset produces a pattern of benefits, then the amortization schedule should be a reflection of the pattern of benefits provided by that asset. However, in order for this to occur, the pattern must be able to be determined reliably. In cases where the pattern cannot be determined in a reliable manner, then the asset will be amortized using a systematic basis taking into account the acquisition cost of the asset and the residual value of the asset after its useful life is complete. The charge from the amortization of the asset is either recognized as a profit or a loss, if it is not required by IFRS to be part of the

cost of another asset. In some circumstances, it is appropriate to consider revenue-based amortization. Such circumstances are: The tangible asset is expressed as a measure of revenue, and the correlation of the revenue generated by the asset and the consumption of economic benefits provided by the asset is high.

D. The accounting principles provided in IFRS standards that allow companies to capitalize R&D costs that have met the strict criteria provided in IAS 38, are in my opinion superior to U.S. GAAP requirements of companies to expense all costs related to R&D at the time of their incurrence. Allowing companies to amortize the intangible assets created during research and development provides a more accurate portrayal of the bottom line of a company. I believe this is due to the fact that these assets provide economic benefits in addition to revenue generation. Only allowing the expenses related to research and development to negatively impact the income statement (under U.S. GAAP), ignores the benefits provided from these expenditures.

E. *Refer to footnote 14 where Volvo reports an intangible asset for "Product and software development." Assume that the product and software development costs reported in footnote 14 are the only R&D costs that Volvo capitalizes*.

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

Ending balance of capitalized product and software development costs, net of accumulated amortization is 11,409 (Swedish Krona). The line item that reports this number is provided in note 14 as "Net carrying value in balance sheet 2009" listed under the column "Product and software development"

ii.

Product and Software Development (Net)			
Beg. Bal (2009)	12,381		
Capital Expend.	2,602		
		3,126	Amortization
		*448	Net of other costs
End. Bal (2009)	11,409		

Amounts in Swedish Krona

* Beg Bal + Cap Expend. – Acc. Amort. – End Bal.

* 12,381 + 2,602 – 3,126 – 11,409 = 448

F. *Refer to Volvo's balance sheet, footnotes, and the eleven-year summary. Assume that the product and software development costs reported in footnote 14 are the only R&D costs that Volvo capitalizes.*

i. *Complete the table below for Volvo's Product and software development intangible asset.*

(in SEK millions)	**2007**	**2008**	**2009**
1.) Product and software development costs capitalized during the year	2,057	2,150	1,858
2.) Total R&D expense on the income statement	11,059	14,438	13,193
3.) Amortization of previously capitalized costs (included in R&D exp.)	2,357	2,864	2,830
4.) Total R&D costs incurred during the year = 1 + 2 – 3	10,759	13,634	12,221

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

2007 = 19.12% 2,057 / 10,759 = 19.12%

2008 = 15.77% 2,150 / 13,634 = 15.77%

2009 = 15.20% 1,858 / 12,221 = 15.20%

G. *Assume that you work as a financial analyst for Volvo Group and would like to compare Volvo's research and development expenditures to a U.S. competitor, Navistar International Corporation. Navistar follows U.S. GAAP that requires that all research and development costs be expensed in the year they are incurred. You gather the following information for Navistar for fiscal year end October 31, 2007 through 2009.*

Navistar International Corporation (U.S. GAAP)

(in U.S. $Millions)	**2007**	**2008**	**2009**
Total R&D costs incurred during the year, expensed on the Income Statement	375	384	433
Net Sales, Manufactured products	11,910	14,399	10,028
Total Assets	11,448	10,390	10,028
Operating income before Tax	(73)	191	359

i. *Use the information from Volvo's eleven-year summary to complete the following table*

(in SEK Millions)	**2007**	**2008**	**2009**
Net Sales, Industrial Operations	276,795	294,932	208,487
Total assets, from balance sheet	321,467	372,419	332,265

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

Navistar International
2007 = 3.15% 375 / 11,910 = 3.15%

2008 = 2.67%	384 / 14,399 = 2.67%
2009 = 4.32%	433 / 10,028 = 4.32%

Volvo Group

2007 = 3.89%	10,759 / 276,795 = 3.89%
2008 = 4.62%	13,634 / 294,932 = 4.62%
2009 = 5.86%	12,221 / 208,487 = 5.86%

Analysis and Reporting of Data Analytics and its Impact on the Accounting and Financial Fields

Specifically

Alteryx Operating System

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

Alteryx is a data analytics operating platform that offers a variety of tools useful for data preparation, blending, and sharing, as well as the generation and analyzation of models. Alteryx was founded by three individuals with backgrounds in the business information technology field; CEO Dean Stoeker, CTO Ned Harding and CCO Olivia Duane Adams. *Alteryx's* vision has been to provide all fields of work with an operating system that creates self-service design to data analytics. Through the help of *Alteryx's* data analytics software companies can begin to truly unlock their potential with deeper insight into the interworking of their business model in far less time and with a much lower cost than previously available. Offering solutions for the communications, oil and gas, analytic consultants, retail, healthcare, transportation and logistics along with many others, there does not seem to be a realm of business or a business model that could not benefit from the efficiency of the *Alteryx* Operating System.

1.) History and Purpose of *Alteryx*

Alteryx is a software platform designed to provide businesses with the ability to analyze, filter, prep, and blend data to increase performance and efficiency in a number business models and applications. *Alteryx* was founded by Dean A. Stoeker (Chairman and CEO), Ned Harding (CTO), and Olivia Duane Adams (CCO) in 1997, with their headquarters located in Irvine, CA. *Alteryx's* versatility is apparent with a diverse customer base ranging from Coca-Cola to Audi to Hyatt Resorts and Western Union. *Alteryx's* adaptability gives customers a great deal of liberty by providing code-free and code-friendly interfaces. In the most basic sense, *Alteryx* can be described as a facilitator for business users to compile and cleanse data from multiple sources to build models and reports. With *Alteryx* companies can eliminate the man-power associated with analyzing, gathering and prepping data from multiple applications. In the past data compilation of this degree would require a knowledge of code and the ability to link multiple sources of data to produce the information that is pertinent to the business, but *Alteryx* has also eliminated this need with its "Click-not-code blending" to filter, group, extract and join data. These processes can also be save, repeated and shared amongst departments in a business to refresh analysis and save time and money across all facets of a company.

In order to run *Alteryx* on a desktop all that is needed Microsoft Windows 7 or later, 32-bit processing, processing speed of 2.5 GHz, 4G ram and a disk size of at least 500 gigabytes. To run Alteryx on a server 64-bit processing is required, processing speed of 2.5 GHz, 16G ram and 1 Terabyte disk size.

Installation	Operating Platform	Machine Requirements	Chip	Processor	Ram	Disk Size
Desktop	Windows 7 or later	64-bit	Quad Core I7	2.5 GHz	8G	500GB – 1TB
Server	Microsoft Windows Server 2008R2	64-Bit	Quad Core Intel Xenon	2.5 GHz		1TB

2.) What special skills are needed to use *Alteryx*? How might I as a student gain these skills?

While there are no specific skills needed to use the *Alteryx* operating platform, having the ability to write code and understand popular coding languages will allow a user to get closer to unlocking *Alteryx's* full potential. For first time users, there are a great deal of resources, including video tutorials explaining the basic functions of the software on *Alteryx's* website. As a student obtaining a free trial

through the *Alteryx* website would be a great way to experiment with the software and maybe gain a better understanding to make yourself more attractive to a potential employer.

3.) Scenarios related to the areas of Auditing, Tax Planning, Financial Statement Analysis/ Valuation/Advisory in which *Alteryx* can be used to increase the efficiency, and or better the effectiveness of a firm or company.

A.) Auditing

1. In the course of an internal audit an internal auditor will begin by establishing the priority areas of the audit. These priority areas can be more thoroughly checked with more specific filtering techniques offered by the *Alteryx* operating system. The *Alteryx* system can establish data bases in which search queries can be used to find data that is crucial to completing an internal control review in less time, saving the client substantially. In some cases, sections of the audit could be performed electronically by the *Alteryx* system and the results can be displayed in a number of formats, identifying trends and detected areas of risk. Using the stronger filtering abilities of the *Alteryx* system an Internal Auditor may more quickly perform transaction testing and more accurately detect situations in which transactions may be misstated or incorrect in the financial statements.

2. In the event of an external audit it is crucial to be able to provide all the data needed to the professional performing the audit. Providing this data in a timely and organized manner is key to keeping the cost of the audit low while also increasing its accuracy. *Alteryx* provides features that enable the data imputed into the system to be organized into columnar or spatial formats with just a few clicks. These features decrease the amount of time spent copying and pasting vast fields of data that are in most cases going to need to be reformatted to have any form of clarity. While there are many advantages for a company to use the *Alteryx* platform for audit, an Auditor may find even more advantages of using the software. *Alteryx* could greatly reduce the amount time spent sifting through financial statements and purchase orders to find relevant information. Less time spent on a particular audit will provide an auditor with the ability to pick up more clients, thus increasing his or her value to a firm.

3. Using *Alteryx's* multiple presentation formats and models will increase the likelihood a more effective reporting process to a company at the completion of an audit. Using the "Parse and Transform" tools provided by *Alteryx* an auditor or company could better display the importance of the results found during an audit. Text can be split and rearranged into to provide a more easily viewable format. Date and time data can be transformed into a variety of formats, including both expression-friendly (minable with a search query) or human readable. Data can be parsed, matched or replaced into normal syntax with the

"RegEx" tool, greatly reducing the amount of time needed to read and restructure data into a format that is more user friendly. In addition to the formatting a, total number of certain records passing through a data stream, this can provide a streamlined approach to obtaining the total number of certain records a company has on file.

B.) Tax Planning

1. With the Recent release of the new Tax Bill, many new changes to how much corporations and small businesses will be taxed. On the corporate side, the new tax rate under the *Tax Cuts and Jobs Act of 2017* has been set at 21%. While many corporations have already begun planning to save additionally on the taxes they will need to pay, prior to the passage of the *Tax Cuts and Jobs Act of 2017* there was a great deal of speculation by businesses as well as individuals on what the new reform bill would include. *Alteryx's* "Drag and Drop Environment" would have been a valuable tool to produce analysis through models and provide mock-ups for potential circumstances. Now that the tax reform bill has been passed *Alteryx* may still be used to streamline the collection of data and records that may be used to lower the total taxable income of a corporation.

2. With the use of *Alteryx*, tax return filing can be made much easier and can become more organized for firms who find themselves completing thousands of forms a year. Using the "Sort" tool in the data prep toolbox, employees can sort records based on values in one or more fields. This option can allow for a much more organized return filing process by grouping returns based upon the amount a client may receive back on the return or any other value listed on the return. In addition, *Alteryx's* operating platform has been seen to decrease the data prep by up to 30%, allowing data analyst with more time to analyze the data they have gathered, create models and test alternative solutions to offer the best option to their client. For tax planning purposes the time saved in data preparation and the ability to test alternative ways of filing for taxes could save a company thousands, that they otherwise would have not.

3. In the instance that a client has asked you to manage their estate and do what is allowed to minimize the tax levied on their assets, you inevitable will find yourself filing a Form 706 tax return. With a client of this caliber it is important to do everything in your power and legal bounds to provide them with the best result you can offer. In most cases this type of return will require the valuation of many different assets as well as their appreciated values. Keeping these values and data organized in a manner that is easy to access and easy to understand will be vital to providing the client with a clear understanding as to the steps taken to lower the amount paid in taxes. Using *Alteryx's* "Field Summary Report" tool a tax planner will be able to produce a concise report that includes descriptive statistics to better present the findings and results of the work

performed for the client. In addition to a "Field Summary Report" a tax planner may also find the "Decision Tree" function rather useful to make decisions on the sale or transfer of certain in an "if-then" format. Along with making decisions this tool can also provide a trail of evidence which can later be used to provide greater proof to a client that all alternatives were taken into account in order to provide them with the best result.

C.) Financial Statement Analysis/Valuation/Advisory

1. After the 2008 financial crisis, the financial services industry has changed in ways it has never done before. In order to better serve customers and make provide services that set them apart from their competition, firms need up-to-date analysis and rapid information dissemination. In a more specific situation, assume you are an Advisory partner, and you have been asked to contacted by a client for counsel on whether his company should acquire a smaller competitor. After some preliminary research and meeting with the client, you decide it would be profitable for the acquisition to take place. How will you prove to the client that he should follow through with the acquisition? Use *Alteryx's* data blending system to pull data from a myriad of sources (spreadsheets, financial statements, accounts, invoices, etc.) to produce concise models that can be easily adjusted for fluctuations in the market. In addition to the ability to adjust, the models can be saved and shared to provide transparency to your client's shareholders that their management is making a profitable investment

2. *Alteryx* provides a much faster and more thorough data filtering with its query records that are based an expression, or date filter macros. These filters can be used to locate in data that would normally take long periods of time or outside sourced help to locate, thus lowering the costs to the firm of hiring outside analysts and experts. In addition, "record ID's" can be linked certain forms using a unique identifier. In some cases, these filtering techniques can be used to locate missing information needed to complete a client's profile, while others they may have a use in locating funds that could have been misallocated or are missing. While no executive likes to discover that funds may be missing it however, is a fact that many will face in their tenure as business professionals. Having software that has the capabilities to discover shortages much faster and cost effective will not only increase the bottom line of a firm or corporation, but also the integrity of all individuals employed there.

3. Faster systems that can handle data from a greater variety of sources can speed up and increase the number of projects that an advisory firm can take on, in addition data can be stored in a variety of places from the desktop to the cloud or even third-party systems providing a nearly endless pool to pull data or store

data in. The speed and efficiency offered by *Alteryx's* software platform is a vital tool for firms in the industry of financial advisory. This speed not only will cut back on the number of hours needed to complete a task for a client, it can also increase the number of clients and projects a particular employee may be able to reasonable take on. *Alteryx* also provides multiple data storage locations for projects. If a client is seasonal their data may be stored on an employee's desktop during the time it is needed, and stored in the cloud or through a third-party system. While not only providing an ease of acquisition for relevant data, the multiple locations in which data can be stored provides for an almost endless pool of data that can be used to help create sample data which may help prove a decision to a client.

4. Why would an accounting partner want to invest in *Alteryx* software?

   Alteryx is an operating system that offers nearly endless possibilities for individuals who are trained and knowledgeable with the many platforms and functions it offers. The implementation of *Alteryx* can make a huge impact on a business in nearly every field. Most importantly, the amount of time spent prepping data and formulating models from that data will be significantly reduced. This time saved is beneficial in a number of ways. Most executives will view saved time as saved money, less can be spent paying overtime to employees. Less overtime leads to employees getting to spend more time outside the office with family and friends providing for a stronger work-life balance and happier, more productive employees in the office. In addition to lower costs, the efficiency of the *Alteryx* system can increase the number and thoroughness of projects taken on by a firm, broadening the client base and improving the bottom line. The ease of data sharing is another benefit to the *Alteryx* system, allowing the spread of important information quickly through a firm allowing for better real-time decision making for employees and partner alike. Training and mastering the *Alteryx* platforms is a vital tool for any firm, not only increasing the workload that can be handled during a given day, but also decreasing the money spent on outsourcing analytics to third parties. Less outsourcing creates fewer ways in which a breach of confidential information can occur.

   With more and more firms beginning to blend traditional business with data analytics it is only a matter of time before the accounting profession is completely advisory and analytics based. Every day we hear of more of terms like "big data" and "data mining" and a new skillset is required to remain competitive in the accounting industry. Knowledge of platforms like *Alteryx* will become crucial to employment practices in the future. *Alteryx's* diverse capabilities make it one of the most useful tools for this industry and will certainly be part of the practice in years to come.

Accredited Works

https://www.alteryx.com/

https://taxfoundation.org/final-tax-cuts-and-jobs-act-details-analysis/

http://www.auditnet.org/audit-library/the-internal-audit-process-from-a-to-z-how-it-works

https://www.careersinaudit.com/article/the-basics-of-external-audit/

Analysis and Reporting of Long-term Debt

Rite Aid Corporation

Specifically

The Reporting and Accounting of Secured and Unsecured debt

Analysis and Report Disclosed by:

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ACCY 420

University of Mississippi

Executive Summary

Rite Aid is a large U.S. pharmacy retailer headquartered in Camp Hill, Pennsylvania. Rite Aid is a leader in more than half the markets that it operates in and filled over 300 million prescriptions in 2009 alone. In this case we were asked to take a closer look at Note 11, Rite Aid's Indebtedness and Credit Agreement. After some analysis it was evident that Rite Aid was carrying a number of forms of debt with a range of interest rates. There are a couple of reasons why a company may have a variety of debt forms with varying interest rates. The first and most common reason is that the company is financing a number of separate activities. The debt forms with lower interest rates may be linked to real estate on which Rite Aid has stores or long-term notes that are secured with some form of collateral. Other forms with higher interest rates could be linked to short-term loans that are not secured with a form of collateral. It was stated that at least one form of this debt was a revolving line credit line, which operates by extending credit as soon as the remaining balance from the prior extension is paid. This form would most likely be in use to cover the high costs associated with Rite Aids prescription orders and inventory. To ensure proper payment of the interest and principal payments associated with these forms of debt, the interest payments were organized and calculated for all forms of debt and amortization schedules were created to track the amortization of discounts were applicable.

A. *Consider the various types of debt described in note 11, Indebtedness and Credit Agreement*.

i. The importance difference between secured and unsecured debt is that a lender in a secured debt contract has access to some form of collateral. In an unsecured debt contracts the lender is at risk of a complete loss, there is no form of collateral that is owed to the lender if the debtor is unable to pay. For Rite Aid the difference between their secured and unsecured debt is that, Rite Aid's ability to borrow money under their revolving credit facility (senior credit facility valued at 1,175,000 (in thousands)) is based upon a specific borrowing base. In short, a senior credit facility is a loan agreement that allows a business to receive multiple types of credit from a single source, in the case of Rite Aid it is revolving credit, Revolving credit is credit that is automatically renewed when the debts are paid off. The borrowing base consists of accounts receivables, inventory and prescription files. As for the unsecured debt, the existence of the senior secured facility previously mentioned, Rite Aid can incur an unlimited amount of unsecured debt that has a maturity date beyond three months after 6/4/14. However, there are other debentures that can limit the amount of unsecured debt that can be incurred, such as certain interest levels not being met at the time of the incurrence of the unsecured debt. These covenants of the senior credit facility contain a greater list and breadth of restrictions placed upon unsecured debt incurrence.

   In the event that Rite Aid defaults (including nonpayment), breaches covenant, is guilty of misrepresentation, or files for bankruptcy, the senior credit facility has a number of actions in place to acquire the unsecured debt.

ii. Throughout note 11 of Rite Aid's financial statements there is mention of debt that is guaranteed. Guaranteed debt is debt that has a promise by whomever is making the guarantee to assume the debt obligation of the debtor in the event that they cannot pay the debt. In some cases, the guaranteed may be structured so that the debtor is not responsible for all of the debt, in others the debtor may have to pay all of the debt. This is referred to as a limited or unlimited liability for the guarantee.

   In the case of Rite Aid's unsecured debt that have a guarantee set up with their wholly-owned subsidiaries. The guarantee is designed in a way that the senior secured credit facility and the 9.75% senior secured notes (due 2016) are secured by a lien on the inventory, accounts receivable and prescription files of the subsidiaries participating in the guarantee. This is due to the fact that Rite Aid is a holding company, having no direct

operations and is reliant upon dividends, distributions, other forms of payment from its subsidiaries to complete the payments required by the senior credit facility.

iii. In note 11 there a great deal of mention of “senior”, “fixed-rate”, and “convertible”. All of these terms describe forms of notes. Senior notes are notes that take priority over other forms of debt, most commonly unsecured debt forms. Fixed rate notes are notes that rate of interest does not change over the life of the note or with fluctuations in the market. The fixed rate is determined when the note is created. Convertible notes are notes that be converted into another form, in most cases as a way to pay the creditor. Common forms that a note may be converted into are shares of stock in the company holding the note or into cash that is equivalent to the value of stock.

iv. The explanation Rite Aid’s debt is broken down to a number of forms and interest rates can be linked to multiple sources. The first explanation for more than one form of debt is the variety of assets that Rite Aid is financing. Rite Aid is a retailer therefore it has property on which it has stores, that property requires financing and that financing will provide reason for a lower interest rate. Debt associated with property generally has a lower interest rate because the property acts as a form of collateral for the lender. The intense change in accounts receivable from $526,742 (Feb. 2009) to $955,502 (Feb. 2010) is an interesting factor that may lend itself to why Rite Aid would need as much financing as it does. If Rite Aid’s accounts receivables have gone up that much it is assumed that they would have problems with cash flow which would lead to a more financing in order to keep the business operating at normal level. Financing to keep the business operating normally would lead to many different loans ranging from loans to maintain payroll to loans designed to keep pharmaceutical suppliers paid.

B. *What is the total amount of debt that Rite Aid possesses at Feb. 27,2010? What amount of this debt will be due at the end of the 2010 fiscal year?*

i. The total amount of debt on the books for Rite Aid the combination of three forms of debt. The currently maturing portion of long-term debt, long term debt, and capital lease obligations.

The total amount of these is shown below in the order they were listed above: (In thousands)

$51,502 + $6,185,633 + $133,764 = $6,370,899
To reconcile this calculation listed in note 11 as "Total debt" = $6,370,899

The amount of debt that will be due at the end the 2010 fiscal year is the currently maturing portion of long term debt: $51,502

C. *7.5% notes due in March 2017*

i. *What is the face value of these notes?*

The face value of these notes is $500,000. These notes were issued at par, meaning that the face rate (stated rate) and the market rate were the same at the time of issuance. In addition, because the notes were issued at par means that they have no premium or discount to be amortized over the life of the note, thus providing more evidence that the face value is $500,000

ii. *Journal entries for the issuance of the notes*

Cash		$500,000	
	N/P		$500,000

iii. *Journal entry for the annual interest expense*

Interest Expense		$37,500	
	Interest Payable		$37,500

iv. *Journal entry for the retirement of the notes (March 2017)*

N/P		$500,000	
	Cash		$500,000

D. *9.375% notes due in December 2015*

i. *What is the face value of these notes? What is the carrying value at February 27, 2010?*

The face value of these notes is $410,000

The carrying value at February 27, 2010 is $405,951. The reason for these differences is the amount of unamortized discount that is remaining as of February 27, 2010. The reason for this discount is difference in the face rate and the market rate of interest at the time of issuance. In this specific case the market was higher than the stated rate.

ii. *What is the amount of interest expense Rite Aid paid in fiscal 2009?*

In fiscal 2009 Rite Aid paid $38,438
$410,000 x 9.375% x 1 year = $38,437.50 = $38,438

iii. *The amount of interest expense recorded by Rite Aid for the year ended February 27, 2010*

The Interest expense for February 27,2010 is the addition of the cash payment of $34,438 and the unamortized discount of $705.

$34,438 + $705 = $39,143

iv. *Journal entry to record the interest expense on these notes in fiscal 2009*

Interest expense		$39,143	
	Discount on N/P		$705
	Cash		$38,438

v. *Total rate of interest recorded for fiscal 2009*

The total rate of interest for 2009 can be calculated by dividing the interest expense by the carrying value.

$39,143 / ($405,951 - $705) = 9.659%

E. *Considering the 9.75% notes due in June 2016, assume that Rite Aid issued these notes on June 30, 2009 and that the company pays interest on June 30th of each year.*

i. *According to note 11 the proceeds of the notes at the time of issue were 98.2% of the face value of the notes. Prepare the journal entries*

Cash	$402,620		(410,000 x 98.2%) = 402,620
Discount on notes payable	$7,380		(410,000 – 402,620) = 7,380
	Notes Payable	$410,000	

410,000 = face value of the notes

ii. *At what effective annual in rate of interest were these notes issued*

10.1212%; based on a future value of $410,000, present value of $402,620, a term of 7 years and payment of $39,975 $39,175 = $410,000 x 9.75%. The rate was determined using the Rate function in excel

iii.

Year	Cash payment	Interest Expense	Unamortized Disc.	Carrying Val.
6/30/09	-	-	-	$402,620.00
6/30/10	$39,975.00	$40,749.98	$774.98	$403,394.98
6/30/11	$39,975.00	$40,828.41	$853.41	$404,248.39
6/30/12	$39,975.00	$40,914.81	$939.81	$405,188.20
6/30/13	$39,975.00	$41,009.91	$1,034.91	$406,223.11
6/30/14	$39,975.00	$41,114.65	$1,139.65	$407,362.76
6/30/15	$39,975.00	$41,230.00	$1,255.00	$408,617.76
6/30/16	$39,975.00	$41,357.02	$1,382.02	$410,000.00
	$279,825.00	$287,204.78	$7,379.78	

iv. *Journal Entry to accrue interest expense on February 27, 2010, based on the above information*

Interest Expense	$27,167	
Discount on N/P		$517

Interest Payment $26,650

(40,749.98 x 8/12 (months)) = $27,167
(775 x 8/12) = $517
(39,975 x 8/12) = 26,650

v. *The net book value of the note at February 27, 2010*

$403,137 ($402,620 + 517)

Analysis and Reporting of the Stockholder's Equity Section of Publicly Traded Entities

Merck Inc. and GlaxoSmithKline plc

Specifically

The reporting of shares outstanding, treasury stock and Dividends awarded to shareholders

Analysis and Report Disclosed by:

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Executive Summary

Merck & Co., Inc. and GlaxoSmithKline plc, are two of world's largest pharmaceutical and healthcare companies. Merck is headquartered in in New Jersey and is listed on both the New York Stock Exchange and the Philadelphia Stock Exchange. GlaxoSmithKline is headquartered in London and is listed on the London and New York Stock exchange. Since both companies are publicly traded there is a great deal of information that need be disclosed to the public in order to keep investors informed. The purpose of this case was to report on the stockholder's equity of both Merck and GlaxoSmithKline. After analysis of the financial statements provided, the number of shares outstanding was calculated to provide an updated figure after a stock buyback occurred. In addition to the calculation of the number of shares outstanding the market capitalization was quantified to provide a figure of how much Merck's stock was worth in the market. As previously mentioned a stock buyback occurred during the years provided by the financial statements. A buyback may occur for a variety of reasons, the most prominent being to increase the per share value of the stock by removing some of the shares available for trade in the market. Other reasons a buyback may occur is to maintain majority ownership or to maintain voting power. Both companies pay dividends to stockholder's providing investors with an incentive to buy stock as well as a steady income source for those who own stock. Dividend payment also shows strength for a company, exhibiting that they have enough income to pay dividends after expenses have been paid.

A. *Considering Merck's common shares*

i. Merck is authorized to issue 5,400,000,000 shares of common stock. These shares have a par value of $0.01, the total value at par of these shares is $54,000,000.

(5,400,000,000 x $0.01) = $54,000,000

ii. The total number of shares issued in 2007 was 2,983,508,675.
Found on the Consolidated Balance sheet

iii. At December 31, 2007 Merck's common shares issued has a total value of $59,600,000 ($29,800,000 in both 2006 and 2007) which can be reconciled to the total number of shares issued of 5,959,732,012 multiplied by the par value per share of $0.01.

5,959,732,012 x $0.01 = $59,597,320.12, approx. $59,600,000

iv. At December 31, 2007, Merck had a treasury stock account holding 811,005,791 shares.

v. The number of outstanding common shares at December 31, 2007 is equal to the shares issued and outstanding less the shares purchased by Merck as treasury stock

Total shares issued: 2,976,223,33 +2,983,508,675 = 5,959,732,012
Less: Treasury stock purchases bal.(12/31/07). = 811,005,791
Total Number of shares Outstanding (12/31/07) = 5,148,726,221

vi. Merck's Market capitalization on December 31, 2007, when Merck closed at $57.61 a share was $296,618,117,592.

Market Capitalization: Shares outstanding x Market Price per share

5,148,726,221 x $57.61 = $296,618,117,592.

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

Dividends offer a form of steady income for investors; therefore, companies pay dividends to attract investors which can potentially raise the price per share of their stock. Dividends offered on common shares are also much more attractive because common shares can be me much

more easily obtained than preferred shares. Generally speaking, the share price of a company will drop after a dividend is paid. This drop reflects the lowered value of the company after the payout. In some cases, the drop-in share price can be equal to the amount of the dividend. This drop can occur onthe payment date or sometime after.

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

There could be a number of reasons why a company may choose to buyback (repurchase) shares of its own stock. Some companies may be doing so to eliminate the stock being undervalued. A buyback will increase the price per share of the stock because there are fewer shares outstanding. In some circumstances a stock buyback may occur to consolidate ownership. In most companies a share of stock comes with voting rights and in order to maintain a strong voting presence a company may need to buy back stock to do so. In other cases, a company may repurchase stock to improve financial ratios, which can be a sign of some less than desirable management decisions. However, this is not always the situation and sometimes improved financial ratios may be positive result of a stock buyback.

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

To summarize payment of dividends for 2007

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

The credit to Dividends Payable is to account for the increase from 2006 to 2007.
(2007 Dividends Payable) = 831,100,000
(2006 Dividends Payable) = 826,900,000
Increase in Dividends Pay. 3,400,000

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

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

Merck uses a method referred to as the cost method for recording its purchase of treasury stock. The cost method is practiced when the shares are bought back at market value. This amount is recorded as a credit in the treasury stock account. If the stock is to be resold any difference between the purchase price of the stock in sale will be recorded in the Additional Paid in Capital – Treasury Stock account. In a situation where the resale price is greater the price at which the stock was bought back for, the Additional Paid in Capital - Treasury Stock account will be credited for the difference. In an opposite situation where the stock is resold for less the price at which it was purchased, then a debit will be recorded in the Additional Paid in Capital – Treasury Stock account.

ii. According to note 11 in Merck's financial statements, 26.5 million shares were repurchased in 2007.

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

In total Merck paid $1,429,700,000 for stock repurchases. Per share they paid $53.95 per share. ($1,429,700,000 / 26,500,000) = $53.95/share.

iv. By definition an asset is a resource, owned by a company that has some form of future economic value, expressible in a dollar amount. Treasury stock may seem to fit this definition; however, treasury stock is actually recorded as a contra equity account, reducing stockholder's equity. Treasury stock is stock that has been off the market, therefore prohibiting the ability for investors to invest in the company through the purchase of stock.

I. *Determine the missing amounts and calculate the ratios in the tables below. For comparability, use dividends paid for both companies rather than dividends declared. Use the number of shares outstanding at year end for per-share calculations. What differences do you observe in Merck's dividend-related ratios across the two years? What differences do you observe in the two companies' dividend-related ratios?*

	Merck ($)		Glaxo (£)
(in Millions)	2007	2006	2007
Dividends Paid	3,307.3	3,322.6	2,793
Shares Outstanding	5,148.72	2,167.79	218,182
Net Income	3,275.4	4,433.8	5,310
Total Assets	48,350.7	44,569.8	31,003
Operating Cash Flows	6,999.2	6,765.2	6,161
*Year-end stock price	$57.61	$41.94	12.99 or $97.39

*values not listed in millions

	Merck ($)		Glaxo (£)
	2007	2006	2007
Dividends per Share	$0.64	$1.53	.53
Dividend yield (dividends per share to stock price	1.11%	3.65%	4.08%
Dividends payout (dividends to net income)	1.009	0.745	.526
Dividends to total assets	0.068	0.074	0.090
Dividends to operating cash flows	0.473	0.489	0.453

Merck
2007 Computations
Dividend per share (3,307.3 / 5,148.72) = $0.64/share
Dividend yield (0.64 / 57.61) = 1.11%

Dividend payout (3,307.3 / 3,275.4) = 1.009
Dividends to total assets (3,307.3 / 48,350.7) = 0.068
Dividends to Op. Cash flows (3,307.3 / 6,999.2) = 0.473

2006 Computations
Dividend per share (3,322.6 / 2,167.79) = $1.53
Divided yield (1.53 / 41.94) = 3.65%
Dividend Payout (3,307.3 / 4,433.8) = 0.745
Dividend to total assets (3,307.3 / 44,569.8) = .074
Dividends to Op. Cash flows (3,307.3 / 6,765.2) = 0.489

Glaxo
2007 Computations
Dividend per share: Provided (Note 16)
Divided yield (.53 / 12.99) = 4.08%
Dividend Payout (2,793 / 5,310) = .526
Dividend to total assets (2,793 / 31,003) = 0.090
Dividends to operating cash flows (2,793 / 6,161) = 0.453

Analysis and Reporting of Marketable Securities

State Street Corporation

Specifically

The Reporting of Trading, Available for Sale and

Held to Maturity Securities

Analysis and Report Disclosed by:

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University of Mississippi

Executive Summary

State street Corp. is a financial holding company headquartered in Boston, Massachusetts. State Street Corp. operates mainly through its banking subsidiary State Street Bank and Trust, concentrating its services to institutional investors. The two main service lines offered by State Street Corp. are Investment Servicing and Investment Management that include brokerage services, securities financing, deposits, short-term investment facilities and other trading services. Due to the nature of the Marketable securities business, State Street Corp has a different presentation of its financial information. The main differences in the reporting of the marketable securities of State Street is the length of time that the assets are planned to be held for and whether the changes in the market value of these assets needs to be reported regularly. As any wise investment services corporation would, State Street has a diversified portfolio with investments ranging from trading securities, to available for sale securities and held to maturity securities. As previously mentioned the accounting for each of these types of securities is different. Trading securities are purchased with the intent to be sold rather quickly, so it is most effective to account for them at their fair market value in order to reflect capital gains earned upon sale. Available for sale securities are also securities are also recorded at their fair market value, because it is up to management's intent to decide how long they will possess the securities. Some may be held for longer than a year to allow for receipt of dividends, while others may be sold shortly after sale like a trading security. Lastly, State Street possesses some held to maturity securities which are held from the time of purchase until they mature several years later. Held to

maturity securities are generally bonds that provide payment of interest to the owners at regular intervals.

A. *Considering State Street's Trading Securities*

i. Trading security is a generally term for either debt or equity securities that are purchased with the intent to be sold in the near future. In most cases trading securities will remain in the owner's possession for less than a year. The purpose of buying and selling the securities on a short-term basis is to try to profit from a change in the value of the security's value. Buying and selling securities to profit solely on the change in the securities' value is referred to as a capital gain. Trading securities may pay dividends, thus providing a regular income stream for the owner. Trading securities are commonly stocks that are generally bought and sold on exchanges such as the New York Stock Exchange.

ii. To record receipt of a dividend or interest received from a trading security in the amount of $1:

Cash	1	
Dividend Revenue		1

iii. Trading securities are recorded on the balance sheet at their Fair Market Value, and changes to that value are made on a regular basis. The accounting to record a change (increase) to the fair market value of a trading security is show below:

Fair Value Adjustment	1	
Unrealized Holding Gain- Income		1

Note: The unrealized holding gain is reflected in the income statement, that is the reason for the subtitle to the unrealized holding gain account.

B. *Considering State Street's Available for Sale securities (AFS Securities)*

i. Available for sale securities are securities that an entity does not plan to sell in the short term like a trading security. Like trading securities, AFS securities may be debt or equity securities. AFS securities are best described as securities that fall between trading securities and held to maturity securities. From their name held to maturity securities will be held until they mature (usually several years). The length of time that an AFS security is held is based upon the owner's plan or judgement.

ii. To record the receipt of a dividend or interest received from an Available for Sale security in the amount of $1:

Cash	1	
Dividend Revenue		1

iii. Available for Sale securities are recorded at their fair market value and similar adjustments are made to their fair value at regular intervals like trading securities. The major difference in the reporting is the subtitle of the unrealized holding gain (or loss) account. The subtitle for an Available for Sale security is Equity to show that the gain (or loss) flows through comprehensive income and not net income. The accounting to record a change (increase) to the fair market value of an AFS security is show below:

Fair Value Adjustment	1	
Unrealized Holding Gain- Equity		1

C. *Considering State Street's Held to Maturity Securities (HTM Securities)*

i. Held to Maturity securities are debt securities that are being held until they reach their maturity value. Held to maturity securities are typically bonds, along which employ some different accounting techniques that need to be disclosed. Like trading or available for sale securities, Held to Maturity securities are purchased at a market value. The value of the HTM security is based upon the difference (if any) in the rate on the bond (stated rate) and the market rate of interest for a bond of that amount and type. In the event that the market rate of interest is higher than the stated rate the bond will sell at a discount and in event that the market rate of the bond is lower than the stated rate the bond will sell at a premium. If the market rate is equal to the stated rate, then a bond will sell at par Debt Instruments, such as bonds are recorded at their amortized cost and in the event that a discount or premium is recorded it will be amortized upon receipt of interest.

Equity securities such like Trading or AFS securities are not held-to-maturity because in most cases the securities either have no maturity value or it is not the intent of the owner to hold these securities for a long period of time or until their maturity date. Additionally, HTM securities are never adjusted with fluctuations in their market value

ii. No entry is made; no adjustments are made to adjust HTM securities to a new fair market value. The only entry made other than the purchase and sale of HTM securities at maturity is receipt of interest, which is shown below.

Premium

Cash	xx		
Debt Security		xx	(Amortization of Premium)
Interest Revenue		xx	

Discount

Cash	xx		
Debt Security		xx	(Amortization of Discount)
Interest Revenue		xx	

D. *Considering the "Trading account assets" on State Street's Balance Sheet*

i. The balance on December 31, 2012 in the trading account assets is:

$637,000,000 – The market value for these accounts is the same, due to the fact that trading securities are recorded at their fair market value.

ii. The journal entry would reflect a gain due the appreciation of the trading securities that make up the "Trading account assets" account

Fair Value Adjustment	85,000,000	
Unrealized Holding Gain or Loss- Income		85,000,000

(637,000,000 – 552,000,000)

E. *Considering the Balance Sheet account "Investment Securities Held to Maturity" and related disclosures in Note 4.*

i. The December 31, 2012 account balance for "Investment Securities Held to Maturity"

$11,379 in millions (Amortized Cost)

ii. The market value of the "Investment Securities Held to Maturity" account

$11,661 in millions (A higher market value reflects an increase in the Market interest rate)

iii. The amortized cost of the securities is $11,379. Amortized cost of a HTM security reflects the increase or decrease over time from the purchase price to its maturity value. The increase or decrease in the value of the debt instrument shows whether it was purchased at a premium or discount. Reference the entries in C. ii.

iv. The difference in market value and the amortized cost represents the current selling price of the debt instruments similar to the one in consideration (market value) and the change in the value of the bond from its purchase price to its maturity value (amortized cost) at the same point in time. Given that the market value of the HTM securities on State Street's balance sheet is higher than the value of the debt instruments at amortized cost shows that market interest rates are higher at 12/31/12 than they were at the time of purchase.

F. *Considering the balance sheet accounts "Investment Securities Available for Sale" (AFS) and related disclosures in Note 4.*

i. The December 31, 2012 account balance for "Investment Securities for Available for Sale"

$109,682 (in millions) (fair market value)

ii. The amount of net unrealized gains (losses) from sales of AFS securities held by State Street on 12/31/12.

In Note 4 in the "Available for Sale" section of the financial statements, State Street reports gross unrealized gains of $2,001 and gross unrealized losses of $882 resulting in the net amount shown below.

($2,001 – 882) = $1,119, gain (all amounts in millions)

iii. The amount of net realized gains from sales of AFS for the year 2012.

Gross realized gains of $101 and gross realized losses of $46

($101 – 46) = $55, gain (all amounts in millions)

The Impact of this gain would be found in the statement of cash flows. The gain would be added as part of operating income, because it falls into normal business activities for State Street Corp.

G. *State Street's statement of cash flow for 2012 (not included) shows the following line items in the "Investing Activities" section relating to available-for-sale securities (in millions):*

Proceeds from sales of available-for-sale securities $ 5,399
Purchases of available-for-sale securities $60,812

i. Entry to record the purchase of AFS Securities for 2012 (in millions)

Investment in AFS securities	60,812	
Cash		60,812

ii. Entry to record the sale of AFS securities in 2012 (in millions)

Cash	5,399	(Proceeds from Sale)
Unrealized Gain (pre-tax)	67	
Realized Gain		55
Investment in AFS securities		5,411

$5,411 = (5,399 + 67) – 55

iii. Original cost of the AFS securities (in millions)

(Cash Proceeds - Realized Gain) = Original Cost (Book Value)

($5,399 - 55) = $5,344

Analysis and Reporting of the Components of Deferred Income Taxes

Zagg Inc.

Specifically

The affects of Deferred Tax Assets and Deferred Tax Liabilities on Income Tax Expense

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

Zagg Inc. an acronym for "*Zealous About Great Gadgets"* is a company that specializes in the design and production of protective accessories for tablets, smartwatches, laptop computers and phones. Headquartered in Midvale, Utah began sale of protective products in March of 2005. Now a publicly held company, Zagg is listed on the NASDAQ and employees approximately 250 employees. The purpose of this case was to analyze and report on the Deferred income taxes reported by Zagg Inc. Deferred income taxes may be easily overlooked when a company is looking to improve its bottom line, but proper recording and reporting of them can provide a legitimate tax advantage. Income tax expense is the main topic that will be addressed in the disclosure of this case. Income tax expense represents a collection of separate values. The base amount reported as income tax expense is the amount of income tax payable to the applicable tax authority. The remaining amount is the net effect of deferred income taxes. The net effect of deferred income taxes is what makes the accurate reporting of deferred tax assets and deferred tax liabilities so important. If the net effect of the deferred income taxes is influenced more by a deferred tax asset, then income tax expense will be reduced. The opposite is true for a deferred tax liability. Proper accounting for deferred income taxes is paramount with the collection power of the IRS, but it can also potentially benefit a company in in the amount they will be required to pay in taxes in the future.

A. *What is meant by the term "book income?" Which number in Zagg Inc.'s statement of operation captures this notion for the fiscal year 2012? How is a company's book income different than its taxable income?*

The term "book income" is synonymous for income before taxes or financial income. More specifically book income is the income that a company reports on its Income statement, before any taxes are deducted. For Zagg Inc. book income is reported as Income before provision for income taxes.

Zagg Inc. reports $23,898 (in thousands) for Income before provision for income taxes.

Book income differs from taxable in one major way. Taxable Income is subject to rules that outline what the IRS deems reportable as income, whereas book income is based on the rules outlined in GAAP. Income reporting for tax purposes, such as tax return filings, is much like the rules that apply to cash accounting. Taxable income is used to compute income taxes payable. The differences that arise in computing taxable income are based on differences in an asset's tax basis and its book (carrying) value. These differences are referred to as "temporary differences." The tax basis for an asset may differ for a variety of reasons, but one of the most common examples of a temporary difference is in the computation of depreciation for book purposes and tax purposes. For book purposes a business may use the straight-line method of depreciation, whereas an accelerated method such as double-eclining balance may be used for tax reporting purposes. These temporary differences create deferred tax situations. Such situations may be broken down into two more forms based upon whether the deferral will create a future taxable amount or a future deductible amount. Future taxable amounts will lead to a deferred tax liability (DTL) and a future deductible amount will lead to a deferred tax asset (DTA).

B. *Relevant terminology for this report*

i. Permanent Tax Differences: Permanent tax differences are amounts that arise from certain business transactions that due to IRS code are not allowed to be included in taxable income. Examples of such transactions that lead to permanent differences are fines, or interest generated from ownership municipal bonds.

ii. Temporary Tax Difference: As previously stated, temporary differences arise from differences in reporting values of assets. Differences may occur from differing methods use to value assets for tax purposes and

those used to value assets for book purposes. The differences will lead to amounts that may be deductible or taxable in the future. Examples of temporary differences include deprecation method differences and advances in payments (Rent Receipts)

iii. Statutory Tax Rate: The tax rate mandated by law. Taxes such as corporate income tax, sales tax, individual income tax and others that are conceived through legislative processes and enforced by the governing body that mandated the tax.

iv. Effective Tax Rate: The effective tax rate is the average rate that a company or individual pays for a specific tax. For individuals this tax is based on income and for a business this amount is the determined from the rate applied to the pre-tax financial income.

C. *Explanation of why a company reports deferred income taxes as part of their total income tax expense, and why income tax expense is not just a report of their tax bill.*

The main purpose in reporting deferred income taxes is to fully disclose the amount of income taxes that company will be paying to the applicable tax authority. In a more specific sense, deferred income taxes should be reported if there has been the creation of a liability or asset that will cause a future deductible or future taxable amount. In the event that an asset is created (future deductible amount), it is referred to as a Deferred Tax asset or DTA. If a liability is created (future taxable amount), it is known as a Deferred Tax Liability or DTL. Deferred income taxes reported as part of the total income tax expense is done for a number of reasons. Most importantly, deferred income taxes are reported as part of total income tax expense to reflect the amount of taxes that were deducted or owed from prior transactions that created DTAs or DTLs. In addition to the current income tax benefit or provision applicable to the income tax expense for a reporting period, companies should record and disclose deferred income taxes on the balance sheet to keep track of deferred income taxes that are not current. The non-current portions of deferred income taxes may extend into the future for a number of years, thus creating a situation where the future taxable or deductible amounts will be realized in future reporting periods. Simply applying the statutory rate to the amount of taxable income recognized under the rulings of the IRS tax code would not reflect the effects that deferred taxes have on the overall income tax expense that should be reported by a company. The latter is an appropriate measure for calculating income taxes payable which should be reported as a liability on the company's balance sheet. Income tax expense is represented as the amount of the income taxes payable plus or minus the net effect of deferred income taxes. A company should not solely report the amount of their tax bill as income tax expense

because of the effect that deferred income taxes have on the income tax expense. The effects of deferred income taxes can create situations in which a company reduce the amount of taxes owed in a certain period, which in turn can allow the company to maintain solvency. Reporting deferred income taxes as part of income tax expense provides for full disclosure and more effective tax payment for companies and individuals alike.

D. *Explanation of what deferred income tax assets (DTAs) and deferred income tax liabilities represent (DTLs), including situations in which either could arise.*

As previously mentioned certain situations will create deferred income tax assets and deferred income tax liabilities. DTAs and DTLs arise from transactions that create what is known as a temporary difference. Temporary differences in valuation due to a change from GAAP reporting to tax reporting. A DTA is created when a temporary difference results in a future deductible amount, whereas a DTL results in future taxable amount. A future deductible amount decreases the amount of taxable income in the future resulting in a lowered income taxes payable. In contrast, a future taxable amount results in an increase in future taxable amounts leading to a higher income tax payable amount. A variety of situations may lead to the creation of either a DTA or a DTL and it is not abnormal to have both DTAs and DTLs effecting the same period income tax expense. A common way a DTA is created is in the event of a net operating loss as the result of pending litigation. To comply with IRS reporting rules a company may not record this amount as a loss until the loss is realized (litigation is complete). The result of this reporting leads to pre-tax financial income (GAAP) being greater than taxable income (IRS code). The difference in the taxes that will be paid before and after the loss is recognized is the DTA. A DTL may be created by a difference in the method used to report depreciation by the company and that which is required by GAAP. The difference in the depreciation method leads to a difference in the value of the asset on the books and its value for tax reporting purposes. Generally, the value is greater on the books than it is under IRS code creating a DTL in the amount of the difference in value.

E. *Description of a tax valuation allowance, and when it will be recorded.*

A tax valuation allowance is the portion of a deferred tax asset (DTA) for which it is more likely than not that a company will not realize a tax benefit. Meaning, a portion deferred tax asset (a future deductible amount) will not be realized (deducted from the overall income tax expense).

A tax valuation allowance will be recorded in the event that a DTA's tax basis (carrying value for tax purposes) is reduced. A reduction of a DTA's tax basis could occur for a number of reasons. One example of how a tax valuation allowance could arise is an inaccurate prediction that a net operating loss will be

reported at year end. A company may build a DTA account that is larger than the benefit received from a net operating loss or if a net operating loss does not end up occurring.

F. Considering the information in Note 8 – Income taxes

i. *Using information in the first table of Note 8, show the journal entry that Zagg reported for the income tax provision in fiscal 2012.*

Entry for the income tax provision in fiscal 2012 (in thousands $)

Income Tax Expense	9,393	
Deferred Tax Asset, net.*	8,293	
Income Taxes Payable**		17,686

*Total Deferred: Federal Provision benefit + State provision benefit
8,293 = 7,029 + 1,084

**Income Taxes Payable = Sum of Federal, State and foreign current tax provisions: 17,686 = 15,466 + 2,104 + 116

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

Income Tax Expense	9,393	
DTA net of Valuation Allowance*	8,002	
DTL**	291	
Income Taxes payable		17,686

*DTA Net of Valuation Allowance = Total Deferred Tax Assets (2012) – Total Deferred Tax Assets (2011)
8,002 = 14,302 – 6,300

**DTL = Total gross deferred Tax Liabilities (2012) - Total gross deferred Tax Liabilities (2011)

292 = 1,086 – 794 (Off from entry due to rounding)

iii. *The second table in note 8 provides a reconciliation of income taxes computed using the federal statutory rate (35%) to income taxes computed using Zagg's effective tax rate. Calculate Zagg's 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?*

Calculation of Effective Tax rate:
Income tax provision / Income before provision for Income Taxes

$9,393 / 23,898 = 39.30% (Statutory Rate = 35%)

The difference in Zagg's effective tax rate and the statutory rate of 35% can be accounted for by allowance of deferred income taxes benefits or provisions. The net deferred income taxes lead to a reduction of the original provision (17,686) down to (9,393). The effective rate does not include these benefits/provisions in its computation.

iv. *According to the table in note 8 – Income Taxes, ZAGG had a net deferred income tax asset balance of $13,508,000 at 12/31/12. Explain where this amount appears on Zagg's Balance Sheet*

The amount of $13,508 (in thousands) is calculated below:

$13,508 = 6,912 + 6,596

Both amounts are listed on Zagg's balance sheet as "deferred income tax assets", however the difference in their values is represented by a gain of 316 (in thousands) that arose from the deconsolidation of HzO. This gain occurred in 2011, making it subject to tax in that year. Once taxed, the gain reduces the non-current portion of the income "deferred income tax assets" account to 6,596 (in thousands).

Analysis and Reporting of the Procedures of Revenue Recognition

Apple Inc.

Specifically

The Accounting of Revenue Recognition provided by the FASB's ASC 606

Analysis and Report Disclosed by:

Gordon Campbell
ACCY 420

University of Mississippi

Executive Summary

Apple Inc. has become a household name for electronics. You will be hard pressed to find someone who doesn't own an apple product or has a family member that does. Much of Apple's success can be accredited to their revolutionary design, and user friendliness. With the level of success, they have experienced, the issue of revenue recognition under the FASB's ASC 606 is challenge. In 2014 the FASB and IASB jointly issued ASC 606 which outlined the new procedures for revenue recognition. ASC 606 breaks revenue recognition into 5 actions: identification of a contract, identification of performance obligations in the contract, determination of transaction price, allocation of transaction price to performance obligations in the contract and recognition of revenue when the performance obligations are satisfied. The criteria outlined in ASC 606 create a stronger standard by which revenue can be recognized, thus eliminating self-serving recognition tactics used by management to boost earnings and reflect company strength. The collaboration by the FASB and IASB to produce ASC 606 was important to address areas in which the accounting for revenue recognition differed from U.S. standard to International standards. A uniform standard will lead to more honest reporting for corporations conducting business globally.

A. *Definition and explanation of Revenues and Gains*

The term revenue can be defined as the amount of money that a company generates from its normal operating activities. Companies like Apple that are in the manufacturing and sales industry will commonly report the revenue figure as "Sales" or "Net Sales" on their income statement. In some situations, such as the sale of an asset, a company may generate more revenue from the sale than the depreciated value of the asset. The differing value that arises in this situation is known as a gain. Gains provide an inflow of funds much like revenue generation, however there is one major difference. The key difference between a revenue and a gain is that a gain is related to a non-normal operating activity. For Apple a gain may occur if they were to sell a piece of manufacturing equipment or a factory. While this transaction may generate income, the income generated is not part of normal business activities, and it should be reported as a gain.

B. *What is meant by "recognizing revenue." What accounts and financial statements are affected by the process of revenue recognition? What criteria has the FASB created to describe revenue recognition?*

"Recognizing revenue" is a term that describes the process of realizing or earning the revenue that is applicable to a specific transaction. In order for a company to earn or recognize revenue, the goods involved in the transaction have been transferred and payment for these goods has been received. In a legalistic sense revenue is recognized when the performance obligation of parties involved in a transaction have been satisfied, regardless of when payment or goods are received. Several accounts and financial statements are impacted by the process of revenue recognition. Specifically accounts receivable, cash, unearned revenue, and earned revenue accounts, which impact the balance sheet, income statement and the statement of cash flows. In the FASB's ASC 606 criteria are provided to create a uniform process of revenue recognition. The first step of revenue recognition outlined by the FASB is to identify if a contract exists, that creates enforceable rights and obligations. Secondly performance obligations (promises to hold up what is stated in the contract) must be present and identifiable. Third, a transaction price, or amount in consideration for the transaction must be fixed or determinable. Fourth, the transaction price must be allocated across the item(s) involved in the transaction or contract mentioned previously. Lastly, revenue may be recognized when the performance obligations of the involved parties have been satisfied.

C. Referring to Revenue Recognition in Note 1, generally, when does Apple Recognize revenue, and what four criteria do they use to determine when revenue can be recognized.

In most cases Apple recognizes revenue when a product is shipped to the customer. In most situations the time a product is shipped by Apple it has met the company's criteria of revenue recognition. Apple's four criteria to recognize revenue are: evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collection of payments is probable. These criteria are in line with those mentioned previously and are standard for the proper recognition and record of revenue.

D. Definition and Explanation of multiple-element contracts, and the revenue recognition problems they pose.

Multiple-element contracts are situations in which more than performance obligations are present for one party. The most common example of a multiple-element contract is for cell service providers. When a customer enters a service provider's store and purchases a phone/tablet, phone service and/or data plan at what time does the provider recognize that revenue? This is the issue that arises from multiple-element contracts. If the phone were the only item in the contract, then when the payment is received and the phone has been transferred to the customer, revenue may be recognized. However, in the case in which data plans and cell services are also provided, when is the proper time to recognize revenue. If the revenue is recognized for the sale of the plan in the same manner as the sale of the phone mentioned prior, the service provider is recognizing revenue that they have not yet earned. The performance obligation of the service provider is not satisfied until the services outlined in the plan have been provided to the customer. The main issue with the revenue recognition process of multiple-element contracts is that it creates situations in which revenue may be under or overstated at certain times based upon how the company chooses to recognize revenue. In some cases, companies have had to substantially write down their revenue numbers to comply with FASB standards, heavily impacted share price and market share.

E. What incentives do management face to make self-serving revenue recognition choices?

From a broad perspective, managers have a multitude of reasons to recognize revenue in a self-serving way. In a technical sense a self-serving revenue recognition process would lead to more situations in which a company could recognize revenue when it may not be appropriate to do so. A self-serving method of revenue recognition may lead to stronger revenue numbers which can boost shareholder confidence and share price, or it could improve the sales numbers of a specific manager or sales group to drive up their commission earnings. For Apple it may be the former that would be more likely to occur. However, revenue recognition policies brought forth by the FASB's standard

update ASC 606 will create fewer places were companies can cut corners and fluff revenue numbers. The contractual process presented in ASC 606 and mentioned above in part B has clarified what actions must take place in order for revenue to be recognized.

F. In reference to Apple's revenue recognition footnote, when does the company recognize revenue for the following types of sales?

i. iTunes songs sold online

Material sold through the iTunes store is not wholly owned by Apple therefore they are not the sole recipient of the revenue generated through those sales. Apple is only the recipient of a commission on those sales. The other parties involved in the receipt of revenue from those sales are the artist of producer of the content as well as the software developers responsible for the iTunes' store operating platform. Recognition of the commission is the extent of the revenue recognized by apple through sales made in the iTunes store.

ii. Mac-branded accessories (headphones, power adapters etc.)

If Mac-branded accessories are sold in a store then the revenue may be recognized at the point of the sale when both parties exercise their performance obligations. For online sales Apple chooses to defer revenue until the customer has received the product. This process of recognition is due the legality of Apple's sales contract to retain a portion of the risk of loss while the products are in transit.

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

The sales of product made to third parties in India is accounted for by recognition of revenue when the product is shipped. Unlike online sales, sales made to resellers transfer risk and title upon the shipping of the product instead of when the product is received by the customer.

iv. Revenue recognition from gift cards

Revenue from the sale of gift cards is deferred upon the sale of the card and is relieved upon the redemption of the card by the customer. If revenue was recognized prior to the occurrence, Apple would be recognizing revenue without performing its performance obligation to provide credit in the amount purchased on the gift card.

Applicable to all cases herein:

Honor Code

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

Signed: