NAME________________________________

Financial Accounting Exam 3.1

Professors G. Peter and Carolyn R. Wilson

- The exam packet is comprised of:
  1. This 20-page document, which contains the questions you are to answer. Write all of your answers in this document, put your name on each page, and submit the document for grading. Questions are labeled as Parts I: Basic, II: Intermediate and III: More Challenging.
  2. The Final Exam Supplement, which contains **separate** chart of accounts for **each** company, statements for a fictitious company, and statements and select disclosures for the following real companies:
     - **Newell RubberMaid Inc.** is a global marketer of consumer and commercial products including home solutions, writing and industrial tools, commercial, baby & parenting, and specialty products. Brands include Rubbermaid ®, Sharpie ®, Paper Mate ®, Parker ®, Waterman ®,... (2012 10-K, page 3)
     - **European Aeronautic Defence and Space Company (EADS)** manufactures commercial aircraft, civil and military helicopters, commercial space launch vehicles, missiles, military aircraft, satellites, defence systems and defence electronics and services related to these activities.(Annual report, page 15)
     - **Google, Inc.** is a global technology leader focused on improving the ways people connect with information. (2012 10-K, page 3)
     - **For the purpose of this exam, assume all companies' policy is to report working-capital reconciliation adjustments that reflect the net effects of all operating entries during the period on the related accounts.**
  3. Scrap paper. Additional scrap paper is available at the front of the room.
- There are 40 possible points on the exam that can be applied to your course grade. Partial credit will not be awarded, so check your answers carefully.
- Be careful not to get bogged down on a question and spend so much time on it that you don't get to the questions you know how to answer. If you believe a question is ambiguous, describe the nature of the ambiguity and the assumptions you are making to resolve this ambiguity.
- **You have 3 hours to complete the exam.**
- The exam is closed book and closed notes.
- You cannot use a laptop, tablet, cell phone, or other communication or mobile device.
- You may bring a calculator for your individual use (not to be shared with others), but your calculator must not contain course related information. We reserve the right to inspect your calculator and, in our sole judgment, deem it inappropriate for use during the exam. We will have basic calculators available for you to borrow.
- You may bring a hardcopy dictionary for your individual use (not to be shared with others), but it must not contain course related information, either as handwritten notes or attached/inserted notes. No electronic dictionaries allowed. We reserve the right to inspect your dictionary before the exam and randomly during the exam. As a result, we may, in our sole judgment, deem it inappropriate for use during the exam.
- You are required to TURN IN ALL MATERIALS when you have finished the exam, including the exam document, the exam supplement, and all scrap paper (provided). Moreover, once the exam starts, you may not take any materials from the room, including the above and your dictionary, if you brought one.
- Regardless of one's intent, staring at classmates' exams is inappropriate. If you wish to take a break from staring at your exam, stare directly ahead or to either side without looking down.

Section I. Basic Level

Question I-1

The following Basic Level Questions pertain to **Carlstedt's iPhone Accessory Manufacturing Company.** Carlstedt's purchases some of the products it resells to customers and manufactures other products, such as customized iPhone cases it sells to customers.

For parts (a) - (h) you are to record journal entries for **Carlstedt's iPhone Accessory Manufacturing Company.** (1) Write your journal entry in the space provided below each question. (2) Use the *most* appropriate accounts from **Carlstedt's chart of accounts in the exam supplement** (it contains some accounts that are not appropriate).
(1/2 point each, for a total of 4 points)

I-1a

Record a journal entry for the following:

During December 2012, Carlstedt sold products to customers for $1,725. $1,200 was collected at the time of the sale and the remainder was fully expected to be collected in the next 60 days. Carlstedt's policy is to recognize revenue at the time products is sold, providing collection is reasonably assured.

	Debit	Credit

I-1b

Record a journal entry for the following:

During December 2012, products sold in part I-1a above cost $1,035.

	Debit	Credit

I-1c

Record a journal entry for the following:

During December 2012, Carlstedt purchased iPhone accessory products on account for $850. The products do not require any manufacturing so the company will resell the products directly to customers for a profit. The company was invoiced upon delivery.

	Debit	Credit

I-1d

Record a journal entry for the following:

During December 2012, Carlstedt collected $600 due from customers for previous sales.

	Debit	Credit

I-1e

Record a journal entry for the following:

During December 2012, Carlstedt paid $300 for insurance that will provide future benefits. The cost will be expensed when the benefits are realized in the future.

	Debit	Credit

I-1f

Record a journal entry for the following:

During the year ended December 31, 2012, Carlstedt recognized $125 of selling, general, and administrative expense. $100 was recognized when the company received invoices from resource providers. The remaining expense was recognized when the company paid resource providers.

	Debit	Credit

I-1g

Record a journal entry for the following:

When the new equipment leased by Carlstedt was installed, ready to use, and put into production, the company concluded the lease met the criteria for an operating lease. The estimated present value of the $3 thousand monthly future minimum payments of the non-cancelable lease was $50 thousand.

At the commencement of the new lease, record the entry below, IF an entry is required. Otherwise write "NONE" in the space below. (No credit if the space below is left blank.)

	Debit	Credit

I-1h

Record a journal entry for the following:

On December 31, 2012, Carlstedt recognized $50 of depreciation related to the office computer it used in the sales department and $200 of depreciation related to the equipment it used in the manufacturing department.

	Debit	Credit

NAME________________________________

Question I-2

Identify the Carlstedt's iPhone Accessory Manufacturing Company financial statement line items that would have been directly affected (and the direction of the effects) when it recorded the journal entry in question I-1f (recognized SG&A expense) during the fiscal 2012.
(1/2 point per statement, for a total of 2 points.)

If an incorrect entry in I-1f leads to errors here, you won't receive credit here. Thus, check your entry carefully.

Guidance:

(1) Determine the appropriate line item(s) affected using **Carlstedt's** statements. For example, write "cash and cash equivalents" because this is on **Carlstedt's** balance sheet.

(2) Include line item(s) directly affected, including the effect(s) of closing entries for events affecting income. Ignore taxes.

(3) **Identify the subtotal "Net cash from operations" if operating cash flows were affected by the entry. This subtotal is conceptually different from other subtotals.**

(4) **Don't include totals or sub-totals other than "Net cash from operations" indirectly affected by the entry. For example, don't report "Net income" on the income statement. However, "Net income" is NOT a total on the statement of cash flows, so you must include "Net income" if it's affected on the statement of cash flows.**

(5) Multiple lines were included below for each statement, but you may need none, more than one, or all lines. **Write "NONE" if no line item is effected on the statement.**

(6) Indicate if the effect(s) of the entries associated with the above event increased or decreased the line item. Put an X in the appropriate column if the above event increases or decreases that line item. For full credit, be sure to mark only one box in each statement's row. **NOTE: If a reported negative number changes from -2 to -3, it decreases; if it changes from - 2 to - 1, it increases.**

(7) You won't receive credit for a statement if you list line items not affected by the entry: don't guess!

Carlstedt's iPhone Accessory Manufacturing Company 2012 Statements

BALANCE SHEETS Line Items	Increases	Decreases	INCOME STATEMENT Line Items	Increases	Decreases
____________	☐	☐	____________	☐	☐
____________	☐	☐	____________	☐	☐
____________	☐	☐	____________	☐	☐

STATEMENT OF STOCKHOLDERS' EQUITY Line Items	Increases	Decreases	CASH FLOW STATEMENT Line Items	Increases	Decreases
____________	☐	☐	____________	☐	☐
____________	☐	☐	____________	☐	☐
____________	☐	☐	____________	☐	☐

Question I-3

Fill in the box below.
(2 points)

M & E's High Tech Manufacturing Company

Inventories, net (in thousands)	December 31	
	2012	2011
Inventories at FIFO:		
Beginning FIFO balance	$450	$350
Inventory purchases	900	1,000
Inventory sales (cost of sales)	(1,000)	(900)
Ending FIFO balances	350	450
Excess of FIFO over LIFO	(55)	(50)
Inventories at LIFO	$295	$400

Based on the above inventories footnote, what was M&E's LIFO (last-in, first-out) cost of sales for fiscal 2012?

Write your answer in this box:

Question I-4

Fill in the box below.
(2 points)

You currently have $50 in a savings account that earns interest at 6% per year compounded monthly. What is the maximum you can spend on a gift for a friend two years from now if you can only use money accumulated in the savings account? Must round your answer to two decimal places to receive credit.

Write your answer in this box:

NAME________________________________

Section II. Intermediate Level

Question II-1

This question asks you to compute last-in, first-out (LIFO) measures for **Allan's Boat Company**, a retail chain that purchases all of its inventory. It sells a selection of sail boats and marine parts, supplies, accessories, and apparel. The company's fiscal year end is December 31.

Fill in the two boxes near the bottom of the template on the next page:

- LIFO cost of sales for fiscal 2012, and
- LIFO ending inventory for fiscal 2012.

Use the assumptions below and the template on the next page. The template numbers are based on the perpetual LIFO method.

Write your answers in the two boxes at the bottom of the template on the next page.

Allan's Boat Company

Assumptions

Market price, December 31, 2012

$190

Tax rate

40%

Inventory transactions

The company had the following inventory purchases (units and purchase prices), sales (negative units), and ending balances for each year.

	Units	Purchase price per unit
2010		
Purchase on January 1	20	$50
Sales for January 1 - June 30	(15)	
Purchase on July 1	40	$60
Sales for July 1 - December 31	(35)	
Year-end balance	**10**	
2011		
Purchase on January 1	50	$80
Sales for January 1 - June 30	(45)	
Purchase on July 1	70	$90
Sales for July 1 - December 31	(65)	
Year-end balance	**20**	
2012		
Purchase on January 1	70	$100
Sales for January 1 - June 30	(90)	
Purchase on July 1	100	$200
Sales for July 1 - December 31	(95)	
Year-end balance	5	

Allan's Boat Company
LIFO Perpetual

	Units	$50 Layer	$60 Layer	$80 Layer	$90 Layer	$100 Layer	$200 Layer		Total
2011									
Year-end balance	20	5 @ $50	5 @ $60	5 @ $80	5 @ $90			=	$1,400
2012									
Purchase on January 1	70					70 @ $100		=	$7,000
Sales for January 1 - June 30	(90)							=	
Purchase on July 1	100						100 @ $200	=	$20,000
Sales for July 1 - December 31	(95)							=	
Pre-impairment balance	**5**							=	
LCM impairment: market = $190	5							=	
Year-end balance	**5**							=	

(Units through Total columns: "Units"; "Input Costs Layers" spans the six layer columns; "Total".)

LIFO Summary

	Cost of Sales	Ending Inventory
2012		

Fill in the two boxes in the above template.
(1 point each, for a total of 2 points)

Question II-2

This question asks you if should you buy or lease a car, given the assumptions below.

If you lease the car for 36 months, you will pay $400 per month, starting one month after you sign the lease deal. At the end of the lease, you will just return the car to the dealership. If you buy the car, you will borrow the full purchase price of $15,000 with no money down. You can get a loan for 36 months with a 0.50% interest rate per month. You will make your first payment one month after you sign the loan. At the end of the loan, the car will be paid-in-full; you will own the car, with a trade in or resale value of $2,000.

Whether you lease or buy the car, you promise yourself that you will save any difference between the monthly lease payment and the monthly loan payment for the next 36 months. You expect the savings rate to be 0.25% per month for your bank deposits during the next 36 months. So you plan to include the expected monthly savings in your analysis, if the payments are different.

Also, whether you lease or buy the car, you expect to drive 10,000 miles per year and have the same gas and other costs, so you ignore these for your analysis.

Fill in the boxes below.
You must put an "X" in the appropriate Buy or Lease box to receive credit. You will not receive credit if you put an X in more than one box. Indicate the amount saved each month.
(1 point for buy-lease decision and 2 points for monthly savings, for a total of 3 points)

	Buy	Lease
What is your decision? (check only one one box)	☐	☐
How much will you save each month? (write the amount)		

Should you buy or lease the car? How much will you save each month based on your decision?	
Lease parameters	
Lease term (months)	36
Monthly payments	$400
Maximum annual miles	10,000
Purchase parameters	
Purchase price	$15,000
Expected annual miles	10,000
Expected value of car in 36 months (trade in or resale)	$2,000
Bank loan and savings parameters	
Amount borrowed to purchase car	$15,000
Borrowing rate per month for 36 month car loan	0.50%
Expected savings rate per month for bank deposits during lease term	0.25%

Question II-3

The **Carter's Corporation** issued bonds on December 31, 2013. The stated interest was payable at the end of each year. The face value, market rate at issuance, and proceeds at issuance are presented in the incomplete bond attribute table below.

No credit for completing the bond attributes and amortization tables below. However, the related data is needed for the entries below and on the following page.

Carter's Corporation

Issuance Date: December 31, 2013				Contractual Future Cash Flows									
Stated rate	Face value	Market rate at issuance	Proceeds at issuance	31-Dec-14	31-Dec-15	30-Dec-16	30-Dec-17	31-Dec-18	31-Dec-19	30-Dec-20	30-Dec-21	31-Dec-22	31-Dec-23
	$10,000	6.00%	$10,736										

Amortization Table Through End of 2014

Year	Cash paid during year	Interest expense during year	Discount or premium amortized during year	Debt carrying value at year end
2013				
2014				

For parts (a) - (b) you are to record journal entries for **Carter's Corporation.** (1) Write your journal entry in the space provided below each question. (2) Use the *most* appropriate accounts from **Carter's chart of accounts in the exam supplement** (it contains some accounts that are not appropriate).
(2 points each, for a total of 4 points)

II-3a

Record Carter's journal entry to recognize the issuance of the bonds on December 31, 2013.

	Debit	Credit

II-3b

Record Carter's journal entry to recognize the first-year interest expense on December 31, 2014, including any amortization of a premium or discount and accrue the interest payment that is due. Assume the related unamortized discount or premium is classified as non-current.

	Debit	Credit

These Intermediate Level Questions pertain to **Newell RubberMaid Inc. See the exam supplement for Newell RubberMaid's chart of accounts, financial statements, and footnote disclosures.** Use the *most* appropriate accounts from **Newell RubberMaid's chart of accounts in the exam supplement** (it contains some accounts that are not appropriate).

Question II-4

RELEVANT INFORMATION for QUESTION 4
The format for parts (i)-(ii) is the same as the format for clicker questions discussed during class. **You MUST CIRCLE the letter associated with the best response to receive credit.**
(1/2 point each for a total of 1 point)

II-4(i)

CIRCLE the letter associated with the best response.

Based on the available information in the exam supplement, it is reasonable to conclude:

(a) The net effect of operating entries on Newell RubberMaid's balance sheet for Accounts receivable, net was a $110.4 million increase during fiscal 2012.

(b) The net effect of operating entries on Newell RubberMaid's balance sheet for Accounts receivable, net was a $101.2 million increase during fiscal 2012.

(c) The net effect of operating entries on Newell RubberMaid's balance sheet for Accounts receivable, net was a ($101.2) million or a decrease during fiscal 2012.

(d) (a) and (c)

(e) (b) and (c)

II-4(ii)

CIRCLE the letter associated with the best response.

Based on the available information in the exam supplement, it is reasonable to conclude:

(a) Net income attributable to shareholders who owned Newell RubberMaid shares was $401.3 million for fiscal 2012.

(b) Net income attributable to shareholders who owned Newell RubberMaid shares was $319.3 million for fiscal 2012.

(c) At the end of fiscal 2012, parties other than Newell RubberMaid owned shares or other ownership interests in entities Newell RubberMaid controlled.

(d) (a) and (c)

(e) (b) and (c)

Question II-5

II-5a

Record a single journal entry that summarizes the entries Newell RubberMaid recorded during fiscal 2012 to recognize its bad debts expense for accounts receivables. Ignore "other" items.
(1 point)

	Debit	Credit

II-5b

Record a single journal entry that summarizes the entries Newell RubberMaid recorded during fiscal 2012 to repurchase and retire shares of common stock with cash.
Hint: you will need all four rows in the space below.
(2 points)

	Debit	Credit

II-5c

Record a single journal entry that summarizes the entries Newell RubberMaid recorded during fiscal 2011 for impairment charges (note the year is intentionally fiscal 2011).

In a separate footnote, not included in the exam, the company disclosed that this impairment was primarily related to goodwill. For the purpose of this exam, assume the entire impairment charge is related to goodwill.
(1 point)

	Debit	Credit

NAME__________________________________

II-5d

Identify the Newell RubberMaid financial statement line items that would have been directly affected (and the direction of the effects) if Newell RubberMaid had recorded the journal entry in question II-5c (goodwill impairment) during fiscal 2011. NOTE: YEAR IS FISCAL 2011. (1/2 point per statement, for a total of 2 points.)

If an incorrect entry in II-5c leads to errors here, you won't receive credit here. Thus, check your entry carefully.

Guidance:

(1) Determine the appropriate line item(s) [not accounts] affected using Newell RubberMaid's statements. For example, write "cash and cash equivalents" rather than "cash" because this is the description of the line item on Newell RubberMaid's balance sheet.

(2) Include line item(s) <u>directly</u> affected, <u>including the effect(s) of closing entries</u> for events affecting income. Ignore taxes.

(3) **Identify the subtotal "Net cash provided by operating activities" if operating cash flows were affected by the entry. This subtotal is conceptually different from other subtotals.**

(4) **Don't include totals or sub-totals other than "Net cash provided by operating activities" indirectly affected by the entry. For example, don't report "Net income" on the income statement. However, "Net income" is NOT a total on the statement of cash flows, so you must include "Net income" if it's affected on the statement of cash flows.**

(5) Multiple lines were included below for each statement, but you may need none, more than one, or all lines. **Write "NONE" if no line item is effected on the statement.**

(6) Indicate if the effect(s) of the entries associated with the above event increased or decreased the line item. Put an X in the appropriate column if the above event increases or decreases that line item. For full credit, be sure to mark only one box in each statement's row. **NOTE: If a reported negative number changes from -2 to -3, it decreases; if it changes from - 2 to - 1, it increases.**

(7) You won't receive credit for a statement if you list line items not affected by the entry: don't guess!

Newell RubberMaid Inc. Financial Statements

Balance Sheet

Line Items	Increases	Decreases
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐

Statement of Stockholders' Equity

Line Items	Increases	Decreases
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐

Statement of Operations

Line Items	Increases	Decreases
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐

Statement of Cash Flows

Line Items	Increases	Decreases
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐
____________________	☐	☐

NAME________________________________

Question II-6

These questions pertain to various companies' news as reported in the *Wall Street Journal* or the company's press release. There is no additional information provided in the exam supplement. All information needed is provided with the question.

II-6a

As reported in *The Wall Street Journal*, December 9, 2013:

Apple Seeks $15.7 Million From Samsung for Fees

"The U.S. legal system, unlike other countries, doesn't embrace "loser pays," in which the losing party of a lawsuit reimburses the winners' fees and costs.

But after winning nearly $1 billion from Samsung Electronics Co. for patent infringement, Apple Inc. is asking a judge to make Samsung fork over $15.7 million in attorney fees, arguing that it shouldn't be forced to bear the full cost of prosecuting its infringement claims given what it describes as "Samsung's blatant disregard" of the company's intellectual property rights."

Assume the judge rules in Apple's favor, instructing Samsung to pay Apple $15.7 million at a specified future date, and Apple records the amount due when the judge makes this ruling. Determine the direct effect(s) on the following Apple metrics, everything else equal (ignore taxes) when Apple records this entry.
(1/2 point per ratio, for a total of 2 point.)

Guidance:
Include the direct affects, including the effect(s) of closing entries for events affecting income.

You must put an "X" in the appropriate box to receive credit. You will not receive credit if you put an X in more than one box per metric.

	Increases	Decreases	No Effect
Financial leverage (liabilities / assets)	☐	☐	☐
Asset turnover (revenues / average assets)	☐	☐	☐
Gross margin ((revenues - cost of sales) / revenues)	☐	☐	☐
Return on equity (ROE) (net profit / average owners' equity)	☐	☐	☐

II-6b

As reported in *The Wall Street Journal*, September 20, 2013:

"BlackBerry Ltd. took an ax to its operations Friday, saying it would cut its staff by 40% and stop selling devices to consumers after its attempt to regain its footing in the smartphone market failed. ...

But the company now acknowledges those efforts [to compete] have fallen flat, saying it would write off nearly $1 billion in inventory of the new touch screen phones."

As reported in *The Wall Street Journal*, September 27, 2013:

"BlackBerry Ltd. posted a $965 million quarterly loss Friday and left many questions unanswered about the smartphone maker's future, its customers, and a proposed $4.7 billion deal to go private. ...

Excluding a $934 million inventory charge and restructuring charges of about $72 million in the latest quarter, BlackBerry said it lost $2.48 million, or 47 cents a share for the quarter ended Aug. 31."

As reported in *BlackBerry's News Release*, September 27, 2013:

"... loss from continuing operations... includes a ... pre-tax charge against inventory and supply commitments of approximately $934 million...

Cost of sales included the $934 million Z10 Inventory Charge incurred in the second quarter of fiscal 2014."

Determine the direct effect(s) on the following BlackBerry's metrics, everything else equal (ignore taxes) when BlackBerry recorded the journal entry to recognize the $934 million inventory charge.
(1/2 point per ratio, for a total of 2 point.)

Guidance:
Include the direct affects, including the effect(s) of closing entries for events affecting income.

You must put an "X" in the appropriate box to receive credit. You will not receive credit if you put an X in more than one box per metric.

	Increases	Decreases	No Effect
Working capital (current assets - current liabilities)	☐	☐	☐
Asset turnover (revenues / average assets)	☐	☐	☐
Net cash from operations	☐	☐	☐
Gross margin ((revenues - cost of sales) / revenues)	☐	☐	☐

Section III — MORE CHALLENGING

Question III-1

The following More Challenging Level Questions pertain to **European Aeronautic Defence and Space Company (EADS)**, which reports under IFRS (International Financial Reporting Standards).

RELEVANT INFORMATION for QUESTION III-1

Base your responses to parts (a) & (b) on the **EADS supplement** and on the guidance, simplified assumption and company disclosure below:

Guidance

- **Capitalized cost:** A cost is capitalized when an asset is recognized at the time the cost is incurred. For example, costs associated with acquiring PP&E are capitalized when PP&E is acquired.
- **Product development** refers to the steps taken to transform an idea into a product. Generally, product development costs are not capitalized under US GAAP. Rather, they are expensed as incurred. More generally, research costs and development costs are both expensed as incurred and often reported together on the income statement as research and development expense.
- Under IFRS, research costs and development costs incurred early in the development process (when there is still considerable uncertainty as to whether products will ultimately succeed in the marketplace) are also expensed. Thus, these costs are accounted for the same under US GAAP and IFRS.
- By contrast, product development costs must be capitalized under IFRS once products reach the stage in the development process when it becomes probable they will succeed. There are specific criteria for making this determination. These capitalized costs are subsequently amortized over the expected product life cycle. (Amortization is like depreciation but for an intangible assets). Thus, expenses that are recognized when costs are incurred under US GAAP are postponed under IFRS.

Simplifying assumptions

- **Assume EADS's credit to accumulated amortization for capitalised development costs during the year ended December 31, 2012 is the same as the amortization included in cost of sales.**
- **Ignore the effects of exchange rate differences and reclassifications.**
- **Assume capitalized development costs is a non-current asset.**

EADS Company Disclosure

> "Capitalised development costs are generally amortised over the estimated number of units produced. In case the number of units produced cannot be estimated reliably capitalised development cost are amortised over the estimated useful life of the internally generated intangible asset. Amortisation of capitalised development costs is recognised in cost of sales. Internally generated intangible assets are reviewed for impairment annually when the asset is not yet in use and further on whenever events or changes in circumstances indicate that the carrying amount may not be recoverable."

EADS 2012 Annual Report, Significant Accounting Policies, page 21

Question III-1a

(3 points)

Assume EADs reported € 1,678 "Profit before income taxes" (in millions of euros) for the year ended December 31, 2012. What would EADS have reported as "Profit before income taxes" (in millions of euros) for this period if it had always accounted for product development costs under US GAAP rather than IFRS?

Assume, all other accounting remains the same and ignore taxes. Also assume reported 2012 income was not affected by impairments or disposals of capitalized development costs.

Note: An implication of assuming "EADS had **always** accounted for product development costs under US GAAP" is you can ignore the capitalized development costs reported on EADS's balance sheet at the start of 2011 when determining the income EADS would have reported under US GAAP. More specifically, you can focus on flows in and out of capitalized development cost, net.

Write your answer in this box: [ ]

Question III-1b

(1/2 point each for a total of 2 points)

Identify how the ratios below would change (relative to those based on EADS's actual reported IFRS numbers) if EADS were to restate its reported numbers to what they would have been if it had always accounted for product development costs under US GAAP.

Assume, all other accounting remains the same and ignore taxes. Also assume reported 2012 income was not affected by impairments or disposals of capitalized development costs.

If an incorrect answer in part (a) leads to errors here, you won't receive credit here. Thus, check your part (a) entry carefully.

Guidance:

Include the direct affects, including the effect(s) of closing entries for events affecting income.

You must put an "X" in the appropriate box to receive credit. You will not receive credit if you put an X in more than one box per metric.

	Change in ratio if product development costs had always been accounted for under US GAAP rather than IFRS		
	Increases	**Decreases**	**No Effect**
Working capital (current assets - current liabilities)	[ ]	[ ]	[ ]
Financial leverage (liabilities / assets)	[ ]	[ ]	[ ]
Gross margin ((revenues - cost of sales) / revenues)	[ ]	[ ]	[ ]
Asset turnover (revenues/average assets)	[ ]	[ ]	[ ]

NAME________________________________

Question III-2

The following More Challenging Level Questions pertain to **Google, Inc.**

RELEVANT INFORMATION for QUESTION III-2

This question asks you to record Google's stock-based compensation expense for the year ended December 31, 2012 and to identify the financial statement effects of this entry. This background information briefly explains the concept of stock-based compensation. It also provides a fictitious example of a stock-based compensation entry.

Share Based Compensation Concept

Stock-based compensation pertains to compensation employees receive that is tied to their employer's share price. Options are a pervasive type of stock-based compensation. Options give employees the right to purchase their employer's stock at a price specified when the options are awarded — the exercise price. Typically, the exercise price equals, or is very close to, the stock's fair value on the date the options are awarded — the grant date — and employees can't exercise the options until after a pre-specified period when employees earn the right to exercise the options, called the vesting period. Once vested, employees can exercise options at any time during the exercise period, which typically extends for ten or more years.

Google uses stock options and restricted stock units (RSUs) for stock-based compensation. When employees are granted RSUs (at the grant date), they are awarded the right to receive shares at the end of a vesting period, providing they meet certain performance goals or don't leave the company.

Accounting for Stock-based Compensation

Depending on the type of award, companies can receive three benefits in exchange for stock-based compensation awards: (1) service from the employee during the vesting period, (2) cash from the employee, typically when they exercise stock options and (3) tax benefits from the government. Companies account for all three types of benefits during the life of stock-based compensation arrangements. However, here we will focus solely on accounting for the value the company receives from the employee's service during the vesting period, which Google refers to as "stock-based compensation expense."

The amount of stock-based compensation recognized during the vesting period depends on the estimated value of the award at the grant date. The value of an RSU award is the fair value of the company's shares on the grant date. The value of a stock option award at the grant date is determined using an option pricing model. (These models are beyond the scope of this discussion). The award's estimated value at the grant date is recognized ratably straight line over the vesting period as indicated in the following fictitious example.

Fictitious Example

- On January 1, 2012, Smith Company grants an option to an employee that can be exercised at the end of a four year vesting period. On this grant date, the value of the option is estimated to be $8. Given these facts, Smith Company will recognize the $8 of stock-based compensation expense ratably on a straight-line basis over the four-year vesting period, or $2 of expense each period.

- The entry to recognize the stock-based compensation expense each year is debit "stock-based compensation expense" and credit "paid-in capital," each $2. The debit to the expense represents the cost to acquire the employee's service during the year and the credit to paid-in capital represents the employee's equity claim (e.g., the stock option).

Aside: This is a highly unusual expense. In fact, strictly speaking it doesn't meet the definition of an expense under either US GAAP or IFRS. Both standard setting bodies' definitions are associated with a decrease in net assets, but the entry to record stock-based compensation doesn't affect assets, nor liabilities. Regardless, both boards refer to this as an expense.

- The SEC has ruled that stock-based compensation expense should be assigned to the same line items on the income statement that cash compensation for the employees is assigned. If the employee in the above example worked in Smith Company's marketing department and the company reported "marketing expense" on its income statement, the $2 recorded to stock-based compensation expense would be assigned to this line item. Alternatively, the $2 could be recorded directly to a marketing expense account.

Additionally, you will need to refer to Google's stock-based compensation expense note at the bottom of Google's income statement in the exam supplement.

III-2a

Record a single journal entry that summarizes the entries Google recorded during fiscal 2012 to recognize stock-based compensation expense.

HINTS:

- **Google's fiscal 2012 numbers are in the RIGHT column.**
- Use the most specific, appropriate accounts in Google's chart of accounts in the exam supplement. Google reports more detail than most companies, so more specific accounts are needed.
- You need to use all 6 rows in the space below.

(3 points)

	Debit	Credit

NAME________________________________

III-2b

Identify the Google financial statement line items that would have been directly affected (and the direction of the effects) if Google had recorded the journal entry in question III-2a (stock-based compensation expense) during during fiscal 2012.

Note: the stock-based compensation expense you recorded in III-2a excludes $43 million related to discontinued operations. Ignore this difference when identifying the financial statement effects.

(1/2 point per statement, for a total of 2 points.)

If an incorrect entry in III-2a leads to errors here, you won't receive credit here. Thus, check your entry carefully.

Guidance:

(1) Determine the appropriate line item(s) [not accounts] affected using Google's statements. For example, write "cash and cash equivalents" rather than "cash" because this is the description of the line item on Google's balance sheet.

(2) Include line item(s) <u>directly</u> affected, <u>including the effect(s) of closing entries</u> for events affecting income. Ignore taxes.

(3) **Identify the subtotal "Net cash provided by operating activities" if operating cash flows were affected by the entry. This subtotal is conceptually different from other subtotals.**

(4) **Don't include totals or sub-totals other than "Net cash provided by operating activities" indirectly affected by the entry. For example, don't report "Net income" on the income statement. However, "Net income" is NOT a total on the statement of cash flows, so you must include "Net income" if it's affected on the statement of cash flows.**

(5) Multiple lines were included below for each statement, but you may need none, more than one, or all lines. **Write "NONE" if no line item is effected on the statement.**

(6) Indicate if the effect(s) of the entries associated with the above event increased or decreased the line item. Put an X in the appropriate column if the above event increases or decreases that line item. For full credit, be sure to mark only one box in each statement's row. **NOTE: If a reported negative number changes from -2 to -3, it decreases; if it changes from - 2 to - 1, it increases.**

(7) You won't receive credit for a statement if you list line items not affected by the entry: don't guess!

Google Inc. Financial Statements, fiscal 2012

Balance Sheet

Line Items	Increases	Decreases
______________________	☐	☐
______________________	☐	☐

Statement of Stockholders' Equity

Line Items	Increases	Decreases
______________________	☐	☐
______________________	☐	☐

Income Statement

Line Items	Increases	Decreases
______________________	☐	☐
______________________	☐	☐
______________________	☐	☐
______________________	☐	☐
______________________	☐	☐

Statement of Cash Flows

Line Items	Increases	Decreases
______________________	☐	☐
______________________	☐	☐
______________________	☐	☐
______________________	☐	☐
______________________	☐	☐